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The Small Business

COURSE I ORGANIZATION

Based on Business Principles and Management

*by Bernard A. Shilt
and W. Harmon Wilson*



PUBLISHED FOR THE UNITED STATES ARMED FORCES INSTITUTE
BY SOUTHWESTERN PUBLISHING COMPANY

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WAR DEPARTMENT

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[A G 3007 (20 Mar 44).]

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20 March 1944 (Copies for Navy personnel should be requisitioned from Educational Services Section)

TO THE STUDENT

This course has been especially prepared for military personnel! Whatever your branch of the service, you and your friends have probably been doing a great deal of thinking and talking about what you will do when you get back home. Thousands of you will consider the possibility of setting up in some kind of small business of your own if you can get together enough capital. This is a book which will help you—perhaps not to get the capital—but certainly to make sound and intelligent decisions about yourself and a small business of your own.

Before you get far in the course you may decide that the risk of running a small independent business is too great that you have not yet had enough experience, or that you will work for someone else for a while before making up your mind. Do not let that keep you from going on with the course. "The Small Business" provides valuable knowledge for anyone who expects to work in a business of some sort and who hopes to learn enough about business to assume some responsibility.

You cannot learn how to run a business from a book, and this course does not pretend to make you a successful businessman. A careful study of "The Small Business" will, however, help you avoid mistakes. It will give you furthermore, a picture of the problems and responsibilities of the independent businessman which will increase your chances of success if, after finishing the course, you are convinced that you have what it takes to go into business for yourself.

A Self-Teaching Course. If necessary, you can study this course successfully without the aid of an instructor. The authors have provided careful and detailed directions for the work you are to do. They have included self-checks by means of which you can tell how well you are doing—whether you are really mastering the principles and information which the course includes. They have worked out assignments which will give you a chance to put into practice what you have learned. And for all these checks and assignments there are answers in the back of the book. There is nothing to keep you from looking at the answers before you try to work out the problems—nothing, that is, except your interest in getting the most out of the course. If you do not want to waste your own time and cheat yourself, follow carefully the study procedures which the authors have put into the book.

4 Mid-Course Review A mid-course review test has been included on page 124. This provides in brief form an opportunity for you to test yourself on important questions covering the first half of the course. Restudy the chapter in which you will find the answers to the questions that you have missed. When you have satisfied yourself as to your understanding, proceed with the course.

5 End-of Course Review At the end of the course there is an end of course review test. You should follow the same procedure for this review test as for the mid-course review test. Both of these review tests will help you to prepare for the final End-of Course Test.

6 Correspondence and Discussion Problems If you are a regularly enrolled student in the United States Armed Forces Institute and want help from an instructor as you work through this course, you will find special problems after the following chapters: Chapters III, VI, IX, and XII. Write out your answers to these assignments as you come to them and send the answers to the United States Armed Forces Institute at Madison, Wisconsin, or to a branch of the Institute if there is one nearer than Madison. You may use any suitable paper available. Be sure to enclose your name and address, give the title and number of this manual, and give the numbers of the pages of the textbook on which the assignments appear.

You will receive from the Institute the suggestions of an instructor who has checked your work. He may be able to help you overcome any difficulties you are having in the course. *You are not obligated to send in these assignments.* They are included only for your help and convenience.

If you are working in a class with an instructor, the Correspondence and Discussion Problems may be used for written work outside the class or for class discussion. If you are doubtful about the answers to any of them, re-study your textbook.

End-of-Course Tests

When you have finished this course, you are entitled to take a USAFI End-of-Course Test and to receive a report of your score on the test. USAFI End-of Course Tests may be obtained as follows:

By students enrolled with USAFI If you received this book for individual study through enrollment in the U. S. Armed Forces Institute, you may obtain the End-of-Course Test by sending an *Application for Institute Test or Examination* (ask your Information-Education Officer or your

Educational Services Officer for an application blank) to the Commandant, U S Armed Forces Institute, Madison 3, Wisconsin or to the nearest overseas Institute Branch

By students enrolled in locally organized classes If you received this book through enrollment in a locally organized class you may apply for the End of Course Test through your instructor

By other students If you obtained this book by any means other than enrollment with USAFI or in a locally organized class you may obtain an application for an End of Course Test by writing to the Commandant, U S Armed Forces Institute Madison 3, Wisconsin, or to the nearest overseas Institute Branch

Certificates of Completion

Certificates of Completion, signed by the officers in charge of local education programs, are frequently issued to students who satisfactorily complete courses in locally organized classes. Special USAFI Certificates of Completion are automatically issued by the U S Armed Forces Institute to students who are enrolled in the Institute and who complete USAFI courses and End of Course Tests by individual study

USAFI Certificates of Completion are sometimes required by civilian schools in connection with applications for academic credit. If you have a local certificate for work done in a course based on this book and if a school or college has requested you to submit in addition a USAFI Certificate of Completion in order to obtain credit for the course you must enroll in the Institute in order to apply for a USAFI Certificate of Completion

Other Courses

When you complete this course, you should enroll for *The Small Business, Course 2—Operation*. Course 2 is planned to follow Course 1 and is essential for the man planning to run a small business.

Additional courses that would be very valuable to you if you have never studied them are

Bookkeeping and Accounting Course 1—Fundamental Principles

Bookkeeping and Accounting, Course 2—For a Mercantile Business

Bookkeeping and Accounting Course 3—Advanced Principles Illustrated Through a Retail Store System

Business Arithmetic

Business English

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business that can be operated conveniently by one or a few individuals. Although combinations and monopolies in some branches of industry and business have made it difficult for small enterprises to begin operations there are constantly new opportunities to start into business. Local state and Federal legislation has tended to protect the operator of a small business by eliminating unfair competition and by preventing certain types of combinations.

Many of our present large businesses have begun as small enterprises. One needs only to study the histories of some typical American businesses to discover the importance of the individual in the establishment of a new business.

Opportunities are opening every day. As long as people need to buy food, shelter, clothing, and amusement there will be opportunities in business. Every group of ten thousand people requires about thirty grocers, ten or fifteen bakers, ten or twelve restaurants, and a smaller number of other businesses including tailor shops, furniture stores, garages, and drugstores. Service stations and garages are becoming more numerous largely because of the increase in the number of automobiles. The number of drugstores is also increasing because of the greater variety of articles that such stores can now offer for sale.

A recent survey made by the United States Department of Commerce discloses that there are almost one million small scale retail stores in operation and that the number tends to increase. The report also offers the opinion that small stores will continue as long as they provide services for which society is willing to pay. The elimination of these small stores would result in a shortage of retail facilities for many consumers. Apparently therefore opportunity still exists for the small businessman.

Responsibilities Assumed in Business. Some persons are inclined to look upon a businessman as a capitalist who profits at the expense of others. There is sometimes a feeling that a businessman is successful merely because he had money enough to go into business. The fact that so many

businessmen fail proves however that to be successful the businessman must have many desirable qualities. In most cases he must not only work hard but because of his ownership in the business he must also take certain risks.

For instance an employee who drives a truck for a delivery business has certain definite tasks. He must pick up loads at different places and deliver the loads rapidly but with care. He may have to see that the truck is properly greased and may sometimes be required to make small repairs. If this man buys a truck and goes into business for himself he must not only continue to look after those tasks but must also take on others. He may be able to run the business from his home but he probably must incur some additional expense for an office or a garage. He must assume the responsibility of finding customers who will do business with him; he must persuade those customers to pay a fair price and he must collect the bills; furthermore he must assume responsibility for damage that may occur to the merchandise hauled.

In other words if this workman goes into business for himself he must do some things that his employer formerly did. He must perform some additional functions. If the truckman does not have the ability to do all these tasks reasonably well he will probably earn less money in his own business than he got when he worked for someone else. If he is not careful he may in the end lose his truck and all his savings. It is therefore evident that a business man performs certain functions that are not performed by the average worker. Any additional income that he obtains from performing these functions pays him for the risks he assumes and the added work he performs.

Originating New Businesses People are willing to pay a reasonable price for having ordinary problems solved or simplified. If a person who wants to go into business will think in terms of solving a common problem or simplifying that problem he will more likely be successful than if he were to think in terms of developing some ingenious scheme or novelty. In the pages of almost every news

paper there are stories of new businesses that have been originated as a result of solving old problems or simplifying those problems

The parking lot and the parking garage in our cities have helped to solve a common problem that has arisen out of parking restrictions. Filling stations have taken the place of the old storage tank that every automobile owner used to have in his back yard garage or basement. Traveling libraries built in motor busses, stores on wheels and special demonstration busses have solved common problems or have simplified them. The theater ticket brokerage business is reported to have been started by a person with only a small amount of capital. He discovered that people were willing to pay a fee if someone would simplify the problem of obtaining good theater seats.

The examples given above are typical of the ways in which enterprising individuals have started new businesses. A writer in *Nation's Business* recommends that any person thinking of originating a new business should ask himself the following questions:

1. What do the people I know need?
2. What things are they doing that they dislike doing?
3. What new problems do they face?
4. How could I save their time for them?
5. How could I add to their peace of mind?
6. How could I protect them from something they dread?
7. What could I make or do for them that would save them money?

Selecting the Type of Business Entering business involves many serious problems, the first of which is to decide what kind of undertaking it will be best to follow.

Not all people are qualified to enter the same types of businesses. People differ in education, experience, personal preferences, habits and ability. No one should enter a business just because he believes that it is a good one. On the other hand, a person should not be so determined to start

in business that he will choose an unprofitable type of enterprise just because he likes it

Before selecting a certain type of business a person should consider the following questions

- 1 Does my education qualify me to enter this business?
- 2 What experience have I to qualify me?
- 3 Why have others become successful in this kind of business?
- 4 Am I willing to work harder than some other businessman to make my enterprise a success?
- 5 Are my home conditions such that I can devote to the business the amount of time required?
- 6 Are the prospects for success permanent or only temporary?
- 7 Is the business one that is liable to be displaced by some other type?
- 8 Are the financial requirements within my means?

Qualifications for Success Every person who starts in business and expects to be successful should have some fundamental advantage over his competitor. His advantages may consist of knowledge, skill, or personal qualities. Other advantages may be location, personal prestige, economy, or the ability to give superior service or quality.

One who plans to start a business enterprise should study the opportunities in the community. He should notice which types of businesses are profitable and which are not profitable. There may be six grocery stores in a small town, but not one of them may be making a good profit. On the other hand, there may be ten grocery stores, two of which are making unusually good profits while the others are not successful. The reasons for such difference in success should be investigated.

Suppose for example a person who contemplates starting a dry cleaning business discovers that in his community there are only two establishments of this type, one of which is making a good profit although the other is not making any. He should therefore answer the following questions

while he considers the advisability of starting an establishment of his own

- 1 Why is one establishment making a profit while the other is not?
- 2 What qualifications have I to start in this business?
- 3 What reasons have I to believe that I could obtain enough business to make a profit?
- 4 How could I render unusual service and introduce new ideas that would bring new business?
- 5 In what ways are the services and the prices of the existing establishments unsatisfactory?
- 6 How can the quality of work be improved?
- 7 How much money would be required to start the business?
- 8 Where could a good location be found?
- 9 Where could equipment and experienced help be obtained?

In other words complete estimates of the prospects and the financial obligations must be considered carefully

Sometimes entirely new types of businesses provide opportunities. As such businesses may, however, be only temporary they should be distinguished from permanent types. The Tom Thumb (miniature) golf course was popular as an amusement for only a short time in most parts of the country. On the other hand many roadside fruit stands have proved to be profitable business enterprises. The automobile has created new business opportunities by requiring more garages and service stations. The airplane and many other inventions may also bring new opportunities.

When to Start a Business. One's chances of success in starting a new business enterprise are based largely on education, experience, the amount of money that may be put into the enterprise, careful management and economic conditions. The time for starting a new business enterprise is very important. There is a great advantage in starting an enterprise after a period of falling prices that is when

prices have reached their lowest point. While prices are decreasing steadily, many men quit business or fail. As a result there is less competition after such a period. After prices have reached their lowest point they begin to rise and the demand for goods becomes correspondingly greater. On the other hand, the most unfavorable time to start an enterprise is when prices are falling and many people are losing employment. Anyone thinking of starting a business should consider carefully general economic and business conditions. Business conditions are judged by the so-called business cycle or economic cycle, which is presented in the chart in Illustration No. 1. It is always possible that a few businessmen may be making a profit while business conditions in general are bad. Generally speaking, however, it is undesirable to start a new business during periods of decline or depression.

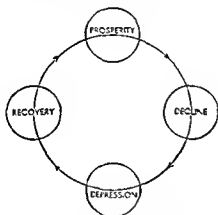


Illustration No. 1—The Business Cycle

The table in Illustration No. 2 presents an analysis of the various phases of the business cycle. During times of prosperity there are liable to be overproduction and too much expansion. These are some of the factors that cause a decline.

It is obvious that, if a businessman can definitely predict the phase of the cycle, he will know when to start a

PROSPERITY	DECLINE	DEPRESSION	RECOVERY
1 Labor is fully employed	1 Profits decline	1 Volume of business is low	1 There is an accumulated shortage of goods.
2 Wages are high	2 Goods are forced onto the market.	2 Buying is only for immediate requirements	2 Most debts are paid
3 Costs of operation increase	3 Prices are reduced	3 Wages are low	3 Outlook is favorable
4 Selling prices increase	4 Buying is reduced	4 Production is efficient.	4 Sales increase.
5 Stocks of goods are large	5 Volume of business decreases	5 Prices are low	5 Construction increases
6 Construction begins to decrease	6 Unemployment results	6 Costs of operation are low	6 Borrowing begins
7 Creditors begin to demand payment.	7 Businesses cease to expand	7 Costs of construction are low	7 Prices begin to rise
	8 Businesses quit borrowing	8 Stocks of goods are small.	8 Buying begins in anticipation of rising prices
	9 Prices decline	9 Shortage of goods develops	9 People go back to work
	10 Creditors press for payment.	10 Interest rates are low	10 Business begins to operate at a profit.
	11 Failures increase	11 Demand for loans is small	

Illustration No 2—An Analysis of the Business Cycle

business, when to purchase generously, when to expand, or when to contract his business. For instance, the best time to start a business is when recovery starts, but it is usually difficult to determine exactly when recovery is in the process. If one waits until the peak of prosperity, he may start the business just before a serious decline. He may enjoy prosperity for a short time and then suffer a severe loss when the decline begins.

The reason it is difficult to determine the existing phase of the cycle is that there are always temporary fluctuations. For instance, in any particular month there may be a spurt in business, when prices may rise and people may go back to work, but soon conditions may grow worse. Long time trends are those that determine the cycle.

Number of Business Failures In an average year it has been estimated that there are 200 000 failures a year in business. Studies made by the United States Department of Commerce disclose that about 70 per cent of all commercial failures occur in the retail trade group. In the United States as a whole there are some types of retail

businesses in which as many as 60 per cent of those who start in business never succeed

A study made in the state of Colorado in the good business years of 1926 1927 and 1928 discloses that about 15 per cent of those in business in 1926 failed within a year. Of those who started business in 1927 40 per cent failed within a year. Similar studies for the state of Illinois and other states show essentially the same facts.

In all these studies the businesses that are most likely to fail are restaurants meat stores and groceries.

Why Businesses Fail Illustration No 3 covers a study of 570 cases of businesses that became bankrupt. This table shows the apparent causes of the failures. It is important to notice that insufficient capital ranks very high in the opinion of both the owners and the creditors. This factor should serve as a warning that it is important to have adequate capital before starting a business. More than 51 per cent of the businesses studied had no accounting records. Out of a total of 570 bankrupts 360 reported that they had not obtained any business information or advice from such sources as credit bureaus or trade associations. In more than 68 per cent of the bankrupt businesses the owners or the managers had not completed a high school education. This fact is evidence that a good education is a prime essential in successfully operating a business.

Warnings and Suggestions Thousands of businesses have failed or have been discontinued for various reasons during the war. After the war many of these will be reopened and there will be thousands of new businesses started. It can probably be safely predicted that business conditions in enterprises filling consumer wants will be good for at least a reasonable time after the war but at the same time there will be strong competition and only the most capable of businessmen will survive.

Education and intelligence are not enough to qualify a person to go into business. Many business failures could probably be avoided if every person who is considering

setting up in business were to serve first as an employee or apprentice for a while in the kind of business in which he is interested. He would then learn something about the business and would have an opportunity to discover whether he is really qualified to run his own business. The person

Causes of Failure (Owners' Opinions)	Percentage of Enterprises Affected	Causes of Failure (Creditors' Opinions)	Percentage of Enterprises Affected
Business depression	67.7	Inefficient management	58.7
Insufficient capital	48.2	Dishonesty and fraud	33.7
Competition	37.9	Insufficient capital	32.9
Adverse domestic and personal factors	35.1	Business depression	29.1
Decline in value of assets	31.6	Adverse domestic and personal factors	28.1
Bad debt losses	29.8	Bad debt losses	17.6
Inefficient management	28.2	Competition	9.1
Excessive overhead expenses	24.0	Excessive overhead	8.9
Poor business location	14.6	Too rapid expansion	7.2
Losses from speculation	11.6	Decline in value of assets	5.8
Unfavorable changes in trading area	11.2	Losses from speculation	5.8
Excessive interest charges on borrowed capital	11.1	Buying too much on credit	3.9
Too rapid expansion	10.5	Poor business location	2.7
Losses from signing notes with recourse	9.6	Decline in rental income	2.3
Buying too much on credit	9.5	Lack of adequate books	2.1
Real estate losses	6.1	Excessive interest charges on borrowed capital	2.1
Lack of adequate books	5.6	Unfavorable changes in trading area	1.9
Automobile accident losses	2.5	Signing notes with recourse	1.4
Failure to carry suffi- cient insurance	2.3	Real estate losses	1.4
Unusual expenses	1.8	Unusual expenses	1.4
Inefficient and dishonest employees	.9	Failure to carry suffi- cient insurance	.7
		Automobile accident judgments	.6
		Inefficient and dishonest employees	.6

Illustration No. 3—Causes of Failure in Bankrupt Businesses

who has not had recent experience in a particular field of business should if possible get up to date experience as an employee before assuming the financial risk required to start his own business in that field. After serving as an employee he may discover that the business is not so attrac-

tive as he thought it was or that there are other reasons why he would not want to start a business of this kind

The study of bankruptcies covered by Illustration No 3 illustrates the fact that too many people who are not qualified go into business. This fact should not necessarily be a discouragement against entering business but it should be a warning that the person who does enter must be qualified. Furthermore anyone who starts an enterprise assumes an important obligation for his welfare is closely related to that of the entire community in which he operates and of the people with whom he deals. Any failure in business is an economic loss that must be borne by society. For example when a retail merchant fails he probably owes money to several wholesalers or manufacturers and to other creditors who must absorb part of the loss. When there are many such losses business in general is seriously affected. In fact several such losses may cause additional failures because certain individual creditors may suffer so badly.

Obligations of the Businessman One of the executives of the Chamber of Commerce of the United States has pointed out the following obligations of a businessman

- 1 To *customers* That they may have the best at the lowest cost, consistent with fairness to all those engaged in production and distribution
- 2 To *workers* That their welfare will not be sacrificed for the benefit of others and that in their employment relations their rights will be respected
- 3 To *management* That it may be recognized in proportion to its demonstrated ability, considering always the proper interest of others
- 4 To *competitors* That there will be avoidance of every form of unfair competition
- 5 To *investors* That their rights will be safeguarded, and that they will be kept so informed that they can exercise their own judgment respecting their interests
- 6 To the *public* That the business will strive in all its operations and relations to promote the general wel-

fare and, without yielding its rights of petition and protest, to observe faithfully the laws of the land

Sources of Information. The person who is considering the question of starting a business enterprise should obtain as much information as he can to guide him in making his decision and in operating the business. The following are sources from which much information can be obtained

United States Department of Commerce

Chambers of commerce

Service Bureau of the Metropolitan Life Insurance Company

Manufacturers of office and store equipment

Trade associations

Credit bureaus

Better business bureaus

Bureaus of business research

Banks

Libraries

The United States Department of Commerce and some of the other Federal departments issue bulletins designed to help the man who is organizing or operating a business. A catalogue of these publications can be obtained from the Department of Commerce or from the United States Printing Office

The following are some examples of the types of literature available from the United States Department of Commerce

Causes of Commercial Bankruptcies

Credit and Payment Terms

Exclusive Sales Agreements

National Retail Credit Survey

Candy Distribution in the United States

Commercial Survey of Philadelphia Marketing Area

Aids to Retail Grocery Profits

Market Research Sources

Survey of Retail Management Practices

The United States Chamber of Commerce, state chambers of commerce, and local chambers of commerce are interested primarily in promoting better business relations, the welfare of business enterprises, and civic improvement. These organizations either supply information on business

conditions and operations or give directions as to the sources of such information. Some chambers of commerce act as branches of the United States Department of Commerce. Many local organizations of this type give advice and aid in the development of new business enterprises.

The following are examples of some of the printed pamphlets that are available from the United States Chamber of Commerce:

- Planning Your Business Ahead
- The Relation Between Chain Stores and Local Chambers of Commerce
- Retailers' Expenses
- Small Store Advertising
- Small Store Arrangement
- Special Sales Events
- Store Opening and Closing Hours
- Discriminatory Legislation Affecting Retailers
- Evaluation of Territory and Customers
- Burglary and Robbery Insurance
- The Fire Insurance Contract
- Organization Plans for Budget Control
- Perpetual Inventory and Stores Control

The Service Bureau of the Metropolitan Life Insurance Company co-operates with many business concerns and trade associations in making available information on accident prevention, budgetary control, better accounting methods, new products, sales outlets and many other matters. Printed information is available free or at a reasonable price.

Manufacturers of office and store equipment, as well as trade associations such as the National Retail Grocers' Association and the National Retail Furniture Association, publish magazines and bulletins on business practices, business conditions, merchandising and advertising. Some of these publications are available free; others are sold.

Credit bureaus are organized locally and nationally. Some are operated by trade associations. Bureaus of this type are in a position to give business advice and should be consulted in organizing and operating a business enterprise.

The National Better Business Bureau and local better business bureaus are equipped to give business advice pertaining largely to promotional schemes and the improvement of business relations

Many of the large universities operate bureaus of business research. The Bureau of Business Research of Harvard University is one of the best known. This particular bureau and some of the others have available bulletins and reports pertaining to business management, costs of operation, business failures, budgeting, accounting methods, advertising procedure, selling procedure, and many other business problems. Some of these bureaus issue monthly or quarterly publications on business conditions.

Banks offer important services to those who are organizing or operating businesses. Every prospective businessman should expect to have friendly and confidential relations with his banker. Before he starts in business, he should consult his banker for advice and for the purpose of reaching some preliminary understanding with regard to credit relations. A banker may often, from experience with other businessmen, make suggestions that will be very worth while in financing and starting a business.

Libraries in cities, schools, and universities provide current books and periodicals that should be consulted in solving many of the problems incidental to starting a business. Many important libraries are also operated by large corporations, business associations and chambers of commerce.

SELF-CHECKING STUDY QUESTIONS

(Chapter 1)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer reread the chapter until you find the correct answer then compare your answers with those on page 299 of this book. Refer to the printed answers only after you have made a serious effort to answer all questions for otherwise the questions will not be of greatest value to you. If you have any incorrect answers reread the part of the chapter in which those questions are discussed.

True-False Questions

Directions After each statement below that is true draw a line under true. After each statement that is false draw a line under false. The first statement is given as a sample.

- 0 In a depression the volume of business is low true false
- 1 Fewer furniture stores are needed than grocery stores true false
- 2 The number of small businesses is decreasing true false
- 3 There are more failures in restaurants than in shoe stores true false
- 4 Large businesses are more efficient than small businesses true false
- 5 Most new businesses succeed true false
- 6 Lack of adequate books (bookkeeping records) is a cause of business failure true false
- 7 In terms of the business cycle it is predicted that there will be a business depression immediately after the war in businesses supplying consumer wants true false
- 8 One of the first things to do in starting in business is to establish relations with a bank true false
- 9 In selecting a particular type of business to enter the factor of experience is important true false
- 10 An economic cycle usually covers a period of less than one year true false
- 11 Buying too much on credit is considered by owners of business as an important cause of failure true false
- 12 In the opinion of business owners business depression is only a minor cause of business failure true false

- 13 A person who goes into business must not only work hard but he must also take certain risks true false
- 14 The obligation of a businessman to his customers is to sell them as much as possible at the highest price true false
- 15 The bad debt losses are considered only a minor cause of business failure true false

Multiple Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement The first is given as a sample

- 0 A small business commonly operated by one person is a (a) wholesale grocery (b) retail store (c) factory (b)
- 16 A period of decline is one in which (a) selling prices increase (b) prices are reduced (c) prices are low ()
- 17 A period of recovery is one in which (a) businesses cease to expand (b) business failures increase (c) businesses begin to operate at a profit ()
- 18 Every 10 000 people require (a) thirty grocery stores (b) ten grocery stores (c) five grocery stores ()
- 19 A good source of information for the prospective businessman is (a) members of his family (b) his minister (c) United States Department of Commerce ()
- 20 In trying to originate a new business an important question to ask oneself is (a) how much money do I have (b) what do the people I know need (c) where can I find a good location ()
- 21 In the business cycle a period of prosperity immediately follows (a) decline (b) depression (c) recovery ()
- 22 The best time in the business cycle to start a business is during a period of (a) decline (b) recession (c) recovery ()
- 23 The department of the Federal government from which a prospective businessman can get the most assistance is (a) Department of Commerce (b) Department of Labor (c) Department of Interior ()
- 24 An analysis of business failures indicates that one of the principal causes is insufficient (a) space (b) capital (c) merchandise ()
- 25 A source from which you can get a catalog of all Federal publications is (a) the Civil Service Commission (b) the Department of State (c) the U S Government Printing Office ()

- 26 Every 10 000 people require (a) twenty or thirty restaurants (b) ten or twelve restaurants (c) five or six restaurants ()
- 27 Insufficient capital ranks (a) high (b) low (c) average as a cause of business failure ()
- 28 The automobile has created new opportunities for small businesses by requiring (a) new types of clothing (b) more traffic lights (c) garages ()
- 29 Inefficient and dishonest employees as a cause of business failure rank (a) low (b) high (c) average ()
- 30 The safest means of starting or creating a new business is by (a) selling a new and novel invention (b) solving or simplifying an ordinary problem (c) buying stock in a corporation ()

PRACTICAL PROBLEMS

(Chapter 1)

Complete the following problems. If you are doubtful about decisions reread the chapter. After you have completed the exercises you will find suggested solutions on page 302 of this book. If your answers do not follow in general the suggested solutions reread the text then write your answers again.

- 1A A milk route salesman who operates a truck owned by a dairy has had the responsibility of developing new customers on a route delivering the dairy products collecting money and delivering the money to his employer. He decides to go into business for himself. He has accumulated what he considers enough money to go into business for himself. Make a list of the additional duties and responsibilities that he must assume.
- 1B List at least ten of the hazards of a man who wishes to start a radio repair shop after the war.
- 1C Select the type of business in which you are most interested. Describe the business and list your qualifications and lack of qualifications under the following two heads: (a) Needed qualifications that I possess to be successful in this business. (b) needed qualifications that I do not possess. After you have made this list give your reasons why you feel that you are or are not qualified to enter this type of business provided of course there is suitable opportunity to do so.

CHAPTER II

FINANCIAL REQUIREMENTS OF STARTING A BUSINESS

Purpose of the Chapter. What is needed in the way of capital to start and operate a business? That is one of the first and most serious questions to be considered. One must either have a sufficient amount of money to start a business, or he must obtain money by borrowing or by selling part of his interest in the business. The discussion in this chapter will be based largely upon the problems of an individual in starting a sole proprietorship type of business. The following are some of the questions that will be answered in this chapter:

- 1 How much money will be required to start the business?
- 2 How can the estimated requirements be computed?
- 3 How soon can the business be expected to make a profit?
- 4 From what sources can money be obtained?

Problem of Working Capital. In a study made by the United States Department of Foreign and Domestic Commerce, lack of sufficient capital is given as one of the important reasons for business failures. An otherwise good business may fail because of lack of sufficient capital. *Capital*, or *working capital*, as referred to in this sense, means money. In general, working capital is the term used to refer to the cash available from day to day, week to week, or month to month, that can be used to pay for wages, rent, purchases, and other current expenses.

In starting a business, a person should not be too eager to own his own building or to buy expensive equipment. This caution applies equally well to the person who has already established a business, for there have been many

Illustration No 4 shows the average expenses of different types of stores. These figures were compiled by the United States Department of Foreign and Domestic Commerce. A table such as this, or other similar tables, may be used in estimating the financial requirements of a business. For instance, let us assume that a person is contemplating going into the retail furniture business. The table shows the percentage of net sales represented by each of various expenses incurred in operating a furniture store. After estimating the sales, it is possible to estimate the approximate requirements of cash needed for the various expenses. In such an estimate the expenses should be considered at a rather high rate and the sales at a rather low figure. For instance, generous allowances should be made for all items such as rent, taxes, and advertising.

Making the Estimate. Many failures and bankruptcies that occur in business are the result of the failure of the businessman to analyze the financial requirements of the business. Optimism takes the place of sound judgment.

After one definitely determines the potential possibilities of the business, he should estimate the financial requirements of starting and operating the business until the time when there will be sufficient income to ensure a profit. The initial amount of money or capital should be sufficient, with the assistance of what loans are available, to carry the business conservatively through the stages of its infancy.

Illustration No 5 shows an example of a sheet that can be used for estimating the cost of equipping a sandwich shop and bookstore. Illustration No 6 is a form for estimating the expenditures of the first month, and Illustration No 7 shows an estimate of the profit or the loss for the same month. In this particular case it is assumed that the sandwich shop and bookstore should establish itself during the first month. Other types of businesses will take a much longer time, and some will require less. From the three tables it is possible to estimate the amount of cash that will be necessary to carry the business through the first month of operation. The owner can therefore judge

ITEMS	PERCENTAGE OF NET SALES									
	Country and foreign stores	Drug stores	General stores	Furniture stores	Department stores	Dry goods	Hardware	Accessories	Shoes	Amusement
Rent	27	47	25	52	30	17	40	43	42	56
Heat light and power	8	15	3	6	7	4	4	0	6	11
Taxes and licenses	7	14	8	10	9	10	14	7	8	16
Insurance	3	5	3	6	7	13	8	8	7	5
Interest	6	5	4	10	7	27	12	9	8	14
Telephone and telegraph	3	4	2	5	4	3	4	3		4
Boxes wrapping and other packing material	4	3	3	2	3	3	1	2	2	6
Postage including parcel post	1	3	04	1	5	2	3	2	3	5
Maintenance and depreciation of delivery equipment etc (exclusive of labor)	9	8	5	18	2		11	2		
Depreciation other than that on delivery equipment, repairs	6	10	3	13	5	8	8	7	2	19
Collection costs including credit association dues	9	1	3	11	1		03	1		2
Advertising	4	7	4	10	17	5	14	12	19	17

Illustration No 4—Average Expenses of Different Types of Stores

in advance how much money must be borrowed, and should have some reasonable idea of whether this money can be paid back on schedule

COST OF ITEMS NEEDED IN EQUIPPING THE BUSINESS	MINIMUM	MAXIMUM
Cash Register	\$ 60 00	\$150 00
Tables	40 00	75 00
Chairs	40 00	75 00
Lamps	20 00	25 00
Rugs	10 00	12 00
Redecoration	25 00	35 00
Dishes	40 00	70 00
Silverware	40 00	60 00
Glasses	12 00	15 00
Stoves	75 00	100 00
Cooking Utensils	30 00	45 00
Grill	10 00	15 00
Toaster	20 00	25 00
Uniforms for Waiters	40 00	48 00
Linens	35 00	40 00
Paper Napkins	10 00	10 00
Others		
Desk	25 00	30 00
Shelves	40 00	50 00
Miscellaneous	50 00	75 00
TOTAL	\$622 00	\$955 00

Illustration No 5—Form for Estimating the Cost of Equipment

Time Required to Make a Profit. The figures in the preceding example are estimates. After the first month definite figures on the operations of that month are available. It is then possible to study the actual figures to see how they compare with the estimates. If, for instance, the total income is \$2,100 and the total expenses are \$1,600, there is an actual profit of \$500 for the first month of operation. The actual figures are consequently more favorable than

the estimates. If the business is profitable during the first month of operation, it should be profitable during succeeding months.

Let us now assume that during the first month of operation the sales amounted to \$1,600 and the expenses to \$1,650. Hence there is only a \$50 loss, which is not a serious loss for a new business. Suppose, however, that during that first month there was a certain unfavorable factor, such as a week of vacation in a neighboring school that deprived the business of some customers. Let us assume that the business during its first month of operation has shown a steady increase in volume each week with the exception of the week of vacation. It could naturally be assumed then that during the succeeding month, under normal conditions, the business should make a profit.

One must recognize that there is a strong possibility that, during the early experiences in operating a business, there will be very little, if any, net profit. Part of the expenses must be paid out of the original capital until the business begins to pay a profit.

In many types of retail businesses it is necessary to operate at least two or three months before the business becomes established. Occasionally a business may become established within a few weeks and become profitable almost immediately, although in certain extreme cases the business must operate for probably six months before it becomes profitable. Many businesses never become profitable, and if a small retail business has not begun to make a little profit within three or four months, the owner should think about changing his methods or discontinuing the business before he loses much money.

Influence of Turnover. It is important to estimate sales carefully and conservatively. The actual cost of the building and the equipment can be computed accurately, but the amount of sales must be estimated. If one is going to sell on credit his money will be tied up until he can make collections. It is therefore important to have a sufficient amount of capital available to finance the business until

collections can be made. For instance, if most of the sales will be made on credit of thirty days and if purchases are made on the same basis the accounts can probably be collected from customers in time to pay creditors. If sales are to be made on a cash basis the cash to pay creditors will be available earlier.

The table in Illustration No. 8 shows the approximate rate of turnover of merchandise for various types of businesses. This ratio indicates the number of times the merchant will buy and sell all the merchandise in his store during the year. Naturally a business with a high rate of turnover needs less capital than one with a low rate of turnover because the former has a smaller amount of money invested in merchandise.

TYPE OF BUSINESS	TURNOVER
Retail grocery stores	9 to 13
Building materials stores	3 to 4
Department stores	2 to 5
Drugstores	2 to 4
Electrical supplies stores	3 to 5
Furniture stores	2 to 4
Hardware stores	1 to 2
Jewelry stores	5 to 1
Men's furnishings stores	15 to 3
Meat markets	50 to 70
Restaurants	30 to 50
Shoe stores	15 to 2
Wholesale groceries	45 to 5

Illustration No. 8—Approximate Rate of Turnover

A turnover of three times a year means that the merchandise is on the shelves an average of four months from the time it is bought until it is sold. If the turnover is twelve times a year, the merchandise is on the shelves an average of thirty days. This table will therefore help in estimating the financial requirements based upon turnover. For instance, if one is contemplating starting a business in which the turnover is four times a year, with most of the goods sold on thirty days' credit (the average collection period being thirty days), the estimated time from the purchase of merchandise until the collection of cash from sales will be about four months (3+1). On the other hand, a

businessman may buy merchandise on thirty days' credit. He therefore must have enough cash available to operate for three months (2+1).

Problem of Obtaining Funds. To supplement his own funds in financing a new business enterprise, a person may obtain capital through a loan from a friend, a bank, a building and loan association, or an insurance company. In some cases capital is obtained through the sale of stock or of a part interest in a partnership. A friend may lend money without security, whereas a bank usually requires security except on some small loans. Money ordinarily cannot be obtained from an insurance company except as a loan on an insurance policy or a mortgage loan on real estate. Wholesalers frequently aid in the establishment of new businesses by granting credit on merchandise that is ordered. The period of credit may be thirty, sixty, or ninety days, depending upon the circumstances.

The advantages and the disadvantages of forming a partnership or a corporation as a means of obtaining funds for a business are discussed in Chapter III.

SELF-CHECKING STUDY QUESTIONS

(Chapter II)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer, reread the chapter until you find the correct answer, then compare your answers with those on page 209 of this book. Refer to the printed answers only after you have made a serious effort to answer all questions, for otherwise the questions will not be of greatest value to you. If you have any incorrect answers, reread the part of the chapter in which those questions are discussed.

True-False Questions

Directions After each statement that is true, draw a line under "true." After each statement that is false, draw a line under "false." The first statement is given as a sample.

- | | | |
|----|--|-------------------|
| 0 | An otherwise good business may fail because of a lack of sufficient capital | <u>true</u> false |
| 1 | A person starting a business should not be eager to own his own building | true false |
| 2 | Credit extended by wholesalers helps a new business to get started | true false |
| 3 | In starting a new business money must be available for future expansion | true false |
| 4 | A shoe store has a relatively high rate of turnover | true false |
| 5 | A turnover of three times a year means that the merchandise is on the shelves of a store an average of four months from the time it is bought until it is sold | true false |
| 6 | In starting a new business one needs only enough money to buy equipment and pay the first month's rent | true false |
| 7 | To conserve working capital it may be advisable to buy equipment on an installment plan or rent it | true false |
| 8 | A loss of \$50 on sales of \$1 600 during the first month of business is unfavorable | true false |
| 9 | Insurance must be included in estimating the cost of starting a business | true false |
| 10 | In planning financial requirements men are inclined to be too optimistic | true false |
| 11 | If one is going to sell on credit he needs more capital than if he is going to sell for cash | true false |
| 12 | Most businesses are profitable during the first three or four months of operation | true false |
| 13 | As soon as a business is making a profit it should own its own building | true false |
| 14 | One can usually borrow money on a life insurance policy | true false |
| 15 | A business should pay cash for its merchandise | true false |

Multiple Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement. The first is given as a sample

- | | | |
|----|--|-------|
| 0 | The approximate turnover of merchandise in a furniture store is (a) 10 to 12 (b) 2 to 4 (c) 6 to 8 | (h) |
| 16 | A source of funds to finance a small business enterprise is (a) a building and loan association (h) the Federal government (c) the local credit bureau | () |

17. The ratio of turnover of four means that merchandise is on the shelves from the time it is bought until it is sold for an average of (a) four months, (b) six months, (c) three months ()
18. The business likely to have the highest turnover is (a) a shoe store, (b) a restaurant, (c) a drugstore. . ()
19. Working capital is (a) debts owed, (b) cash available for current expenses, (c) insurance policies ()
20. Failure is almost certain for a new enterprise if there is insufficient capital (a) to buy a building, (b) to expand the business, (c) to operate during the beginning period when there is little or no profit ()
21. A business has a good chance of success if it can make a small profit or break even during (a) the first few months, (b) the first year, (c) the first five years ... ()
22. In the early stages of a business at least part of the expenses must be paid out of (a) savings, (b) capital, (c) losses ()
23. An expense such as rent is figured as a percentage of (a) gross profit, (b) total expense, (c) net sales ()
24. Figures compiled by the United States Department of Foreign and Domestic Commerce indicate that the type of store which pays the highest percentage of rent is (a) a drugstore, (b) a jewelry store, (c) a shoe store. ()
25. Figures compiled by the United States Department of Foreign and Domestic Commerce indicate that the type of store which pays the lowest percentage of rent is (a) a dry goods store, (b) a grocery store, (c) a hardware store ()
26. Money can be borrowed from an insurance company on (a) real estate, (b) merchandise, (c) reputation ()
27. If one is willing to share an interest in ownership and profits of a business, he can sometimes obtain additional money by (a) borrowing, (b) buying life insurance, (c) forming a partnership ()
28. A business with a high turnover of merchandise as compared with one with a low turnover requires (a) more capital, (b) less capital, (c) the same amount of capital ()
29. A business which sells for cash as compared with one that sells on credit, will require (a) more capital, (b) less capital, (c) the same amount of capital ()
30. In estimating the financial requirements of starting a small business it is better to (a) underestimate expenses, (b) overestimate expenses, (c) estimate the income only ()

CHAPTER III

FORMS OF BUSINESS ORGANIZATION

Purpose of the Chapter. Many small businesses are started by a single individual and operated as sole proprietorships, but some are originally organized as partnerships or corporations. Some businesses that start as sole proprietorships are later changed to partnerships or corporations. Some that are organized as partnerships may be changed to corporations. Corporations are sometimes changed to partnerships or sole proprietorships.

The advantages and the disadvantages of the various forms of organization are discussed in this chapter. The chapter will disclose answers to the following questions:

- 1 Shall the business be organized as a sole proprietorship, a partnership, or a corporation?
- 2 What are the advantages and the disadvantages of the different types of business organization?
- 3 What type of organization is best for a small business?
- 4 What type of organization should one use if he starts a new business?

Section I

Sole Proprietorships and Partnerships

The Sole Proprietorship, a Business Owned by One Person
An enterprise that is owned and operated by a single person is known as an *individual proprietorship*, an *individual enterprise*, or a *sole proprietorship*. Under this form of organization one person usually owns the business, manages it, and is the sole recipient of the profits. The sole proprietor may thus perform the functions of a capitalist, a landowner, and a laborer. He is a capitalist because he owns the business and receives profits from it. He may be a landowner by owning the land on which the place of busi-

working out his own ideas. This feeling stimulates him to work hard to make his business a success.

- 2 Very closely related to this first advantage is the fact that all the profits belong to the sole proprietor. As he is the sole gainer, he is more likely to work overtime and to think continually of how his business can be operated more efficiently.
- 3 Because most proprietorships are small, the proprietor and his employees get to know each other personally. This relationship is conducive to a better understanding and a greater mutual interest between employer and employees. These same benefits should result from the close touch that the sole proprietor has with his customers.
- 4 The sole proprietor is not hindered in making decisions. As he need not consult business associates, he can act promptly in emergencies. If an unusual opportunity to buy merchandise or equipment arises, or if there is a desire to change the location of the business or to sell on credit terms rather than on a cash basis, there are no dissenting partners to hinder such action. Thus the management of an individual enterprise is flexible and can adjust itself easily to changing conditions.
- 5 One can usually commence or cease business activities as a sole proprietor without legal formality. One does not need to consult a lawyer and go through a large amount of "red tape" in order to organize an individual enterprise. In some types of businesses, however, such as a restaurant, it is necessary to obtain a permit or license before operations can be begun.

Disadvantages of the Sole Proprietorship. Although there are many advantages, there are also some disadvantages that confront the sole proprietor. Among the disadvantages are

- 1 Each individual usually has a particular aptitude or ability. In one it may be to sell merchandise; in another it may be to purchase goods; in another it may

be to keep records. All these activities are important to the success of a business, but the sole proprietor is likely to be deficient in judgment or ability in one or more of them. It is therefore easy to understand why many proprietorships end in failure within a short time.

- 2 Often there is need of additional capital for emergencies. Financial assistance on a large scale may be difficult to obtain when so much depends upon one person. The expansion of the business may be retarded because of the lack of capital of the sole owner. The size of the business may, then, be limited to the capital available.
- 3 The sole proprietor assumes a great amount of risk. It is true that he receives all the profits of the business, but likewise, he bears all the losses if the business is not successful. Should the business fail and be unable to pay its debts, the creditors have a claim against any of the assets of the proprietor. He may therefore lose not only the money he has invested in the enterprise but also his personal property, such as his automobile (and in some states, his home).

Kinds of Businesses Suited to the Sole Proprietorship Form of Organization. The sole proprietorship is quite common, the majority of businesses being of this type. The kind of business that is primarily concerned with rendering personal service is well suited to the sole proprietorship form of organization. Dentists, accountants, auctioneers, landscape gardeners, carpenters, painters, tourist camps, barber shops, beauty parlors, shoe repair shops, radio service stores, and automobile repair stations are examples of this class.

Another type of business that seems to be well adapted to the single proprietorship is the one that sells merchandise and service, principally of one kind, and does not require a large amount of capital. Newspaper and magazine stands, roadside markets, rental libraries, tearooms and restaurants, flower shops, gasoline filling stations, retail

grocery stores retail meat markets dress shops automobile parking lots movers of household goods and dry cleaning establishments are examples of this type In general the type of business that can be operated suitably as a sole proprietorship is one (a) that can be managed by the proprietor or by persons hired by him and (b) that does not require a great amount of capital There are of course exceptions to this general class

The Partnership, a Business Owned by Two or More Persons Mr Davis who operates the sole proprietorship mentioned in the preceding discussion is confronted with the problem of expanding his business He is now fifty five years old and has operated the business successfully for many years He sees new opportunities in his community for increasing his business but he does not wish to assume full responsibility for the undertaking He realizes that the expansion of the business would place considerable additional burden on him He also realizes that in order to expand the business he needs additional capital but he does not wish to borrow the money Because of these reasons he decides to take a partner into his business

Mr W H Baker operates an adjoining meat market He is a younger man than Mr Davis and has proved to have both honesty and considerable business ability It is thought that the combining of the two businesses should result in more customers for both groceries and meats Customers who have been coming to the meat market will possibly become grocery customers also and those who have been buying at the grocery of Mr Davis may become meat customers A discussion between the two men leads to a tentative agreement to form a partnership provided a third person can be found to invest \$13 000 in cash In that case Mr Baker will invest in the partnership the net assets of his business and an additional amount of cash to make his investment equal to \$13 000 Each of the three partners will then have a net ownership of \$13 000

Mr Davis and Mr Baker finally find a young accountant J W Miller who has \$5 000 and is able to borrow the re

maining amount. As a result the articles of copartnership shown in Illustration No 9 are written and signed by the three men

Financial Status of the Partnership Under the partnership agreement each partner is to have the same investment in the business. The money invested by Mr Miller is to be used in joining the stores of Mr Baker and Mr Davis to form one large store. The following is a financial statement of Mr Baker's business

ASSETS		CLAIMS AGAINST ASSETS	
Cash	\$ 500	Accounts Payable (Debts)	\$ 100
Merchandise	200	W H Baker Proprietor	
Equipment	1 500	ship	7 100
Land and Building	5 000		
	<hr/>		<hr/>
Total Assets	\$7 200	Total Claims Against Assets	\$7 200

The net worth of Mr Baker's business is \$7,100. In other words, after deducting the amount of his debts from the total value of his assets, he has a net ownership of \$7,100. As Mr Baker's share in the new partnership is to be equal to that of Mr Davis, Mr Baker is required to invest \$5,900 in cash in addition to the net assets of his business. Mr Miller invests \$13,000 in cash.

After the partnership is formed, the financial statement of the business appears as follows

ASSETS		CLAIMS AGAINST ASSETS	
Cash	\$20 400	Accounts Payable (Debts)	\$ 100
Merchandise	3 200	B S Davis Proprietor-	
Equipment	2 500	ship	13 000
Land and Buildings	13 000	W H Baker Proprietor	
		ship	13 000
		J W Miller Proprietor	
		ship	13 000
	<hr/>		<hr/>
Total Assets	\$39 100	Total Claims Against Assets	\$39 100

Operation of the Partnership In operating the partnership, Davis, Baker, and Miller divide the responsibilities. Mr Davis supervises the grocery department. Mr Baker

ARTICLES OF COPARTNERSHIP

This Contract made and entered into on the first day of February 1939 by and between B S Davis of Buffalo New York, party of the first part W H Baker of Buffalo New York party of the second part and J W Miller of Kenmore New York party of the third part

WITNESSETH That the said parties have this day formed a copartnership for the purpose of engaging in and conducting a retail grocery and meat store under the following stipulations which are made a part of the contract

FIRST The said copartnership is to continue for a term of ten years from date hereof

SECOND The business shall be conducted under the firm name of Davis Baker and Miller at 239 Fillmore Avenue Buffalo New York

THIRD The investments are as follows B S Davis Cash \$1 000 Merchandise \$3 000 Equipment \$1 000 Land and Buildings \$8 000 Total Investment \$13 000 W H Baker Cash \$6 400 Merchandise \$200 Equipment \$1 500 Land and Buildings \$5 000 Total Assets \$13 100 less Accounts Payable \$100 equals Net Investment \$13 000 J W Miller Cash \$13 000

FOURTH All profits or losses arising from said business are to be shared equally

FIFTH Each partner is to devote his entire time and attention to the business and to engage in no other business enterprise without the written consent of the others

SIXTH Each partner is to have a salary of \$200 a month the same to be withdrawn at such time or times as he may elect No partner is to withdraw from the business an amount in excess of his salary without the written consent of the others

SEVENTH The duties of each partner are defined as follows B S Davis is to supervise the grocery department W H Baker is to supervise the meat department J W Miller is to have charge of finances and records

EIGHTH No partner is to become surety or bondsman for anyone without the written consent of the others

NINTH In case of the death incapacity or withdrawal of one partner the business is to be conducted for the remainder of the fiscal year by the surviving partners the profits for the year allocated to the withdrawing partner to be determined by the ratio of the time he was a partner during the year to the whole year

TENTH In case of dissolution the assets are to be divided in the ratio of the capital invested at the time of dissolution

IN WITNESS WHEREOF The parties aforesaid have hereunto set their hands and affixed their seals on the day and year above written.

B. S. Davis
William Henry Baker
James W. Miller

supervises the meat department and Mr Miller has charge of finances and records

During the year the three partners remodel the stores and combine them They also buy some new equipment At the end of the yearly fiscal period the following financial statement is prepared to show the status of the partnership

ASSETS		CLAIMS AGAINST ASSETS	
Cash	\$ 5 800	Accounts Payable	
Merchandise	11 500	(Debts	\$ 800
Equipment	10 000	B S Davis Proprietor	
Land and Buildings	16 500	ship	13 000
		W H Baker Proprietor-	
		ship	13 000
		J W Miller Proprietor	
		ship	13 000
		Undivided Profits	4 000
Total Assets	\$43 800	Total Claims Against Assets	\$43 800

Has the partnership had a successful year? Each partner has received a salary of \$200 a month (according to the terms of the partnership agreement), and, in addition, the profits for the year have been \$4,000, which is a return of approximately 10 per cent on the proprietorship Such a return on an investment is usually considered very good Mr Miller, who had to borrow some of the money he used for his investment, probably had to pay 6 per cent interest As he received a return of approximately 10 per cent, the investment was profitable to him also

Other Purposes for Which a Partnership May Be Formed
In addition to the advantages previously explained, there are other reasons for the formation of partnerships Some of them are

- 1 In order to eliminate competition, two or more sole proprietors may combine their businesses by organizing a partnership
- 2 An owner who wishes to retire from active management without retiring from the business may admit a partner to take over the active management

- 3 By the combining of two or more businesses, an economy may be effected through the reduction of certain overhead expenses, such as advertising, supplies, equipment, fuel, and rent

Advantages of the Partnership The following are some of the advantages of the partnership form of business organization

- 1 The business is likely to be operated more efficiently than a sole proprietorship because two or more persons share in the management. One partner may have special sales ability, another may have an aptitude for buying the right kind, quality, and quantity of merchandise. One partner may propose a change in the business and the other partner may be able to point out disadvantages in or modifications of the plan that were not apparent to the one who made the original proposal. The combined abilities of the partners should result in more efficient operation than there would be if each were conducting a business as a sole proprietor.
- 2 When a business is started more capital can be supplied through the investments of two or more people than could be obtained ordinarily by one person. Some businesses require a greater amount of capital for equipment and merchandise than one person might be able to supply, but sufficient initial capital can be obtained if several persons enter into a partnership. As a rule the additional capital needed for expansion is obtained more easily if there are several partners.
- 3 Because it has several owners who are responsible for the ownership and the management, the partnership usually has better credit than the sole proprietorship.
- 4 Each partner is likely to have a large personal following that he can bring to the business.
- 5 Because of their financial responsibilities, the partners will take a greater interest in the business than would be taken by employees hired by the business.

Disadvantages of the Partnership. The following are some of the disadvantages of the partnership form of business organization

- 1 According to law each member of the partnership has an *unlimited* financial liability for all the debts of the business. Each partner is responsible for his share of the business debts but if one or some of the partners are unable to pay their share one partner may have to pay all the debts. Suppose that the partnership of Davis, Baker and Miller should fail and that, after all the business assets have been converted into cash and the liabilities paid with that cash there is still \$9 000 due the creditors of the partnership. Each partner should contribute \$3 000 to the partnership so that there will be enough money to pay the remaining business debts. If both Baker and Miller, however, are unable to contribute their \$6 000, but Mr Davis has enough property the law can compel him to contribute the entire \$9 000. In such a case Mr Davis would then have a *right of contribution claim* against each of the other partners for \$3,000, that is, he would have a claim against these partners and might, if necessary, sue them individually or jointly for the amount that he had had to pay in their behalf.
2. There is always danger of disagreement among partners. The majority of the partners may want to change the nature of the business but are unable to do so because of the refusal of one partner. For example, a partnership may have been formed for the purpose of conducting a retail piano business. After a while the majority of the partners feel that it would be wise to discontinue selling pianos and handle radios. As one partner disagrees, however, the partnership cannot make the change, although the change may seem very desirable.
3. Each partner is bound by the contracts of other partners if such contracts pertain to the ordinary operations of the business. There is always the possibility

of friction and hard feeling between partners if one partner makes a contract that turns out to be unprofitable to the partnership. Furthermore, if there are many partners, certain ones may feel that they are not having their proper share in the management while others have too much authority. This situation may cause disagreements and impair the efficiency of the business. Such a condition may be partly prevented if the articles of copartnership specifically state the duties of each partner.

- 4 The life of a partnership is uncertain. Usually, when the contract for a partnership is drawn up, a definite length of time, such as ten years, is fixed for the existence of the business. If one partner dies, however, there must be a dissolution of the partnership. The deceased partner may have been the principal manager, and, as a result of his death, the business may suffer. Or the heirs of the deceased partner may demand from the surviving partners an unfair price for the share of the deceased partner, or they may insist upon the complete liquidation of the partnership so that they can obtain the share belonging to the deceased partner. In the latter case, the assets that are sold usually do not bring a fair price, and consequently all the partners suffer a loss. Under the laws of most states the bankruptcy of any partner, the entrance of a new partner, and the incapacity of a partner are other causes that may bring a sudden termination of the partnership just at a time when the business is beginning to prosper.
- 5 The amount of funds that a partnership may obtain is limited by the contributions of the partners, the earnings of the business, and the amount that can be borrowed. It is difficult for a partnership to obtain enough capital to carry on a large enterprise unless the members of the partnership are individually wealthy, or unless they are many in number. Too many partners, however, may cause inefficiency in operation.

- 6 Sometimes there is not a satisfactory distribution of the partnership profits according to the ability and the efforts of the individual partners. The profits are shared on the basis of the partnership agreement. If no provision is made in the agreement, the law requires an equal division of the profits. Some of the common methods of distributing profits among partners are equally in ratio to the capital of each partner according to some other agreed ratio, such as 40 per cent to one partner and 60 per cent to the other partner with interest allowed on the capital of each partner and then the remaining profits divided equally or in some other ratio.

Limited Partnership. In an ordinary partnership each partner is liable for the entire debt contracted by the partnership. Under the laws of some states a partnership can be formed that has at least one general partner and one special, or *limited*, partner whose name does not appear in the firm name. In some states the name of the limited partner is included in the firm name. The limited partner is the only one who is not liable for the debts of the partnership in case of bankruptcy. This type of partnership is known as a *limited partnership*. In some partnerships of this type the word *Limited*, or the abbreviation *Ltd*, must be used after the name. Usually the law requires that a certificate of limited partnership be filed in a public office of record and that proper notice be given to each creditor with whom the limited partnership does business. If these requirements are not fulfilled, the limited partners have unlimited liability in the same manner as a general partner.

Joint-Stock Company. The so-called joint-stock company is a form of partnership. The ownership of such a company is represented by shares, or certificates, of stock that ordinarily may be sold at will by the owners, or partners, without consulting the other owners. A change in ownership does not dissolve the joint-stock company as it would an ordinary partnership. The management of a joint-stock

company is in the hands of a board of directors, who are elected by the individual shareholders. The board of directors may operate the business or may hire the necessary individuals to manage the business.

The shareholders of a joint stock company have essentially the same liabilities as the partners in an ordinary partnership. In other words, they are individually or collectively liable for any debts or any acts of the company. This type of company is not particularly common, although some partners prefer to change the form of their organization to a joint-stock company rather than to a corporation.

Kinds of Businesses Suited to the Partnership Form of Organization The partnership form of organization is found in many businesses that furnish more than one kind of product or service. Each partner usually looks after some phase of the business in which he has special ability. Some examples of businesses that are well suited to this form are automobile sales and repair companies, retail grocery and meat markets, restaurants, radio stores with both sales and repair departments, barber shops and beauty parlors, automobile repair and painting shops, camera stores

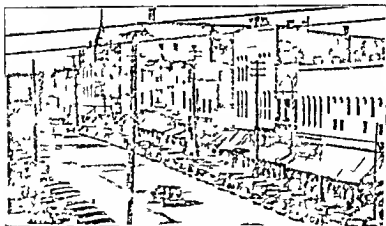


Illustration by L. L. L. L.

Illustration No. 10—Businesses Commonly Operated as Partnerships

with film developing and printing services, men's clothing stores and tailor shops, laundries with dry-cleaning departments and landscape gardeners rendering tree surgery service. For instance, in the case of an automobile company having separate sales and repair departments, one partner may handle sales and the other partner repairs. Some garages have a new car sales department, a used car sales department, and a service department, with a partner in charge of each of the three departments.

SELF-CHECKING STUDY QUESTIONS

(Chapter III, Section I)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer reread the chapter until you find the correct answer. Then compare your answers with those on page 299 of this book. Refer to the printed answers only after you have made a serious effort to answer all questions. For otherwise the questions will not be of greatest value to you. If you have any incorrect answers reread the part of the chapter in which those questions are discussed.

True-False Questions

Directions After each statement below that is true, draw a line under "true." After each statement that is false draw a line under "false." The first statement is given as a sample.

- 0 One of the weaknesses of a sole proprietorship is that the sole owner may not have varied enough ability for successful management. true false
1. In an individual enterprise stockholders receive the profits. true false
- 2 One advantage of an individual proprietorship is that risks are shared with other owners. true false
- 3 It is easier to start or discontinue a corporation than a sole proprietorship. true false
- 4 One of the advantages attributed to a sole proprietorship is that the owner is personally acquainted with his employees. true false
- 5 The management of a sole proprietorship is easily adjustable to changing conditions. true false

- 6 In a sole proprietorship one may perform the functions of a capitalist, a land owner, and a laborer true false
- 7 A sole proprietorship usually has better credit than a partnership true false
- 8 Two sole proprietorships sometimes combine to decrease their income taxes true false
- 9 If one partner signs a contract to buy merchandise the other partners are also responsible true false
- 10 Each member of a partnership has unlimited financial liability for all the debts of the business true false

Multiple-Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement. The first is given as a sample.

- 0 The owner of an individual proprietorship owns all his assets provided there are no (a) bonds owned (b) creditors (c) partners (b)
- 11 An enterprise owned by one person is called (a) a limited partnership (b) an individual enterprise, (c) a corporation ()
- 12 A financial statement of assets and claims against the assets is known as (a) a balance sheet (b) a profit and loss statement (c) a statement of income and expenses ()
- 13 A business commonly operated as a sole proprietorship is a (a) radio service store (b) chain store (c) automobile manufacturing plant ()
- 14 A partnership is a business (a) organized as a closed corporation (b) owned by two or more persons (c) which has at least four owners ()
- 15 The articles of copartnership constitute (a) a contract embodying the operating agreement of the partners (b) an agreement for the dissolution of a partnership (c) a financial statement ()
- 16 A partnership is likely to be operated more efficiently than a sole proprietorship because (a) it has a better legal status (b) it is subject to less taxation (c) two or more persons share in the management ()
- 17 A partnership is often able to operate a larger business than a sole proprietorship because (a) there are fewer restrictions on a partnership (b) more capital can be supplied through investments of two or more

- persons, (c) customers prefer to buy from a partnership ()
- 18 Each partner of a partnership is bound by the following type of contract entered into by other partners
(a) contract to buy merchandise for the business,
(b) contract with another partner to sell his home
(c) agreement to sell the interest of another partner ()
- 19 A limited partnership is one (a) limited in capital
(b) having one partner not liable for the debts, (c) restricted to a specified line of business ()
- 20 A joint stock company is one that (a) is organized for the purpose of owning corporation stock (b) is organized for the purpose of dealing in livestock (c) permits partners to sell their shares or certificates without dissolving the partnership ()

Section II

Corporations and Corporate Combinations

The Corporation, a Business Owned by Stockholders Davis Baker and Miller of the partnership mentioned previously have learned from reading and observation that a large number of small businesses and nearly all the very large businesses are corporations. They believe that there is an opportunity to expand their business by purchasing two small stores and operating the two new stores as branches. They make a study of the corporation as a form of business organization and find that it is an association of individuals organized under a charter granted by the state. It is in a sense an artificial person created by the laws of the state.

The essential characteristics of a corporation are found to be as follows

- 1 The ownership is divided into equal parts called shares of capital stock
- 2 The stockholders own the business (There must be at least three)
- 3 The stockholders elect directors
- 4 The directors formulate general plans and policies and appoint the officers
- 5 The officers in a small corporation usually consist of a president a secretary and a treasurer
- 6 The officers have charge of the active management of the business
- 7 The officers have the privilege of employing additional persons if necessary to operate the business

The corporation is permitted to make contracts to borrow money to own property to sue and to be sued in its own name. Any act performed for the corporation by an officer or an authorized employee is not done in the name of the officer or the employee but in the name of the corporation. For example the treasurer of a corporation has the power to borrow money for the corporation. As he

Management of a Corporation As only the three stock holders own the business they become the directors. Among themselves they elect officers. Mr Davis is elected president, Mr Baker vice president, and Mr Miller secretary and treasurer. A simple organization chart of the new corporation is shown in Illustration No. 12.

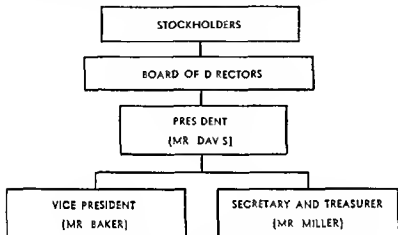


Illustration No. 12 — A Organizational Chart of a Corporation

Each stockholder will have 130 votes on matters arising in the meetings of the stockholders. Voting stockholders usually have one vote for each share owned. Should Mr. Miller sell 66 of his shares to Mr. Baker, Mr. Baker would own 196 shares, or one share more than 50 per cent of the total 390 shares of stock that have been issued. Then Mr. Baker could control the corporation.

The law usually requires a corporation to send each stockholder at a specified time in advance a notice of a meeting to be held by the stockholders. If a stockholder cannot attend the meeting personally, he may be represented by a proxy. A proxy is a written authorization for someone to vote in behalf of the person signing the proxy. It is a common practice for a blank proxy to be included in the letter announcing a stockholders meeting. A form of proxy is shown in Illustration No. 13.

Closed Corporations. A *closed corporation* is one that does not offer its securities for public sale. It is frequently owned by just a few stockholders some of whom may be actively engaged in operating the business in the same manner as partners operate a business. Davis, Baker and Miller, Incorporated, is an example of a closed corporation. The three former partners own all the stock and operate the business.

A closed corporation, under the laws of most states, does not need to make its activities known to the public for its securities are not offered for general sale. It must, however, submit reports to the state from which it obtained its charter, or for tax purposes must submit reports to all states in which it operates.

Open Corporations. An *open corporation* is one that offers its securities for general sale. For the benefit of prospective investors an open corporation must furnish to the public information regarding its earnings, assets and liabilities. These reports must be furnished in accordance with Federal and state laws and the rules of the stock exchanges.

Such corporations often have a very large number of stockholders, some having as many as several hundred thousand. Most of the stockholders in these large corporations own only a few shares, but, because of the great number of stockholders, such a corporation has a very large amount of capital. Naturally, these large corporations are not so simple in organization as Davis, Baker, and Miller, Inc. The form of organization becomes more complicated as the business becomes larger.

Capital Stock. The ownership of a stock certificate of a corporation is evidence of part ownership in the corporation. A stockholder of a corporation does not have the same responsibility as a partner in a partnership; that is, he has no liability beyond the extent of his ownership. If the corporation fails, he may lose the money that he has invested in the corporation, but the creditors cannot collect any additional amounts from the stockholders.

Common Stock The two kinds of stock most frequently issued by a corporation are known as *common stock* and *preferred stock*. So far as profits are concerned the owners of common stock are in much the same position as the partners in a partnership. They participate in the management of the business and share in the profits if there are any. They do not obtain earnings however until all other investors have been paid. Furthermore there is no fixed rate of earning on common stock. The stock issued to Davis, Baker and Miller is common stock. Their ownership of the stock permits them to operate the business.

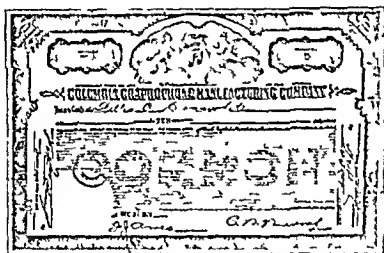


Illustration No. 14—A Common Stock Certificate of No Par Value

Preferred Stock Preferred stock as its name indicates has some kind of preference over the ordinary or common stock. A point of distinction applicable to all preferred stock is preference in the distribution of profits. Whenever profits are distributed the preferred stockholders must receive their dividend first. A corporation must of course pay its regular debts and interest on borrowed money before any dividend can be paid. Holders of preferred stock

usually receive a fixed dividend, ranging from 5 to 7 per cent of the face value of the stock

Let us see just how this plan works out. Suppose that a certain corporation has issued \$50,000 of 7 per cent preferred stock and also \$50,000 of common stock, and that the profits for a certain year are \$4,000. The preferred stockholders will receive their 7 per cent of \$50,000, which is \$3,500. Then there is only \$500 remaining which is available for the common stockholders. But suppose that the same corporation should earn \$12,000 in profits during a certain other year. In this case the preferred stockholders would be paid their fixed rate of dividend (7 per cent), or \$3,500, and there would be \$8,500 left for distribution to the common stockholders. If this whole amount were distributed, the common stockholders would receive a dividend of 17 per cent. It is, however, usually not a good policy to distribute all the profits. It is better to keep some of the profits as a reserve (or surplus). If all the profits are paid out in the form of cash, a company may later need to borrow money in order to carry on its operations. Some corporations prefer to leave a surplus in the business so that, if no profit is earned during a particular period, they may still pay a dividend out of the surplus that was previously earned. If a corporation pays out all its earnings and profits, it may have serious difficulty if a loss is suffered during any particular year. It is good practice for corporations to build up a surplus.

Ordinarily the preferred stockholders do not have any voting privilege in the management of the business, although the ownership of certain types of preferred stock does permit such activity in case dividends are not declared and paid regularly. Some kinds of preferred stock carry a special privilege with regard to claims against the assets. For instance, if the corporation ceases operations, the preferred stockholders must be paid before the common stockholders.

For example, suppose that a corporation has outstanding \$50,000 of common stock and also \$50,000 of stock that is preferred as to assets. During the ensuing liquida-

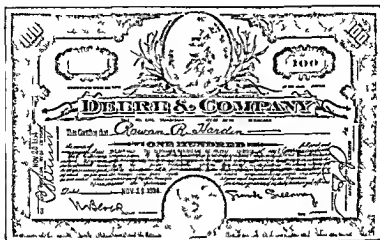


Illustration No 15—A Preferred Stock Certificate
of Par Value

tion process all the assets are converted into cash and all the creditors are paid. There then remains \$80 000 in cash. The sum of \$50 000 must be paid to the stockholders whose stock is preferred as to assets. Consequently the holders of common stock receive only \$30 000. Thus the common stockholders receive only 60 per cent of the full face value of their stock. Had there been no preference as to assets all the stockholders both common and preferred would have shared equally each group receiving \$40 000.

When a corporation goes out of business however the preferred stockholders seldom get much from the assets because the assets usually are sold for much less than their value on the books of the corporation and often do not bring enough to pay the creditors.

Preferred stock may be *cumulative* or *noncumulative*. If it is cumulative the owners are entitled to the payment of a dividend for each year even though the dividend for any particular year was not paid during that year. If for instance profits are not distributed for a year or more all the dividends on preferred stock that were due in the past must be paid to the preferred stockholders before the common stockholders begin to receive any dividends again.

Suppose for example a corporation has \$50 000 of 7 per cent cumulative preferred stock. During one year there are no earnings and no dividends are paid. During the following year the earnings are large. In this second year a dividend of 14 per cent or \$7 000 must be paid to the holders of the cumulative preferred stock before a dividend can be paid to the common stockholders.

There is a common misunderstanding that the rate of dividend specified on preferred stock is guaranteed. It is not guaranteed in any sense of the word but the preferred stockholders must be paid dividends before the common stockholders have a right to any.

If the stock is noncumulative the preferred stockholders are not assured their income in case the corporation ceases temporarily to pay dividends. If the corporation does not earn a profit or have a surplus it may not declare dividends. In such a case the preferred stockholders begin to receive their regular dividend when the company makes profits again but they do not receive dividends for the time when no profits were earned.

Preferred stock may also be classified as *participating* or *nonparticipating*. Ordinarily the common stockholders share in the profits after the preferred stockholders have been paid. If the common stockholders have a right to all the earnings beyond a fixed percentage paid to the preferred stockholders the preferred stock is said to be nonparticipating but if the preferred stockholders share in the excess earnings under some predetermined plan the preferred stock is said to be participating. In other words this stock participates with the common stock in the earnings beyond the fixed rate of dividend paid to the preferred stockholders.

There are many ways in which the preferred stock may participate. For instance the fixed rate for preferred stock may be given to both the preferred and the common stockholders and then all the remainder of the profits may be distributed to the preferred stockholders. In another case the preferred stockholders may receive their fixed rate the common stockholders the same rate, then the preferred

stockholders 4 per cent, the common stockholders 2 per cent, and finally the preferred stockholders the remainder

Which Kind of Stock to Issue. One of the problems that must be decided in organizing a corporation is the amount of capital stock to be issued and the kind or kinds. When application for a charter is made, information must be given as to whether all the stock of the proposed corporation is to be common or whether part is to be common and part preferred, and which kind or kinds of preferred are to be issued. The charter issued to the corporation states the kind or kinds of stock and the amount of each that may be issued. No other kinds can be issued unless authorization is received from the government.

In starting a business, it is usually a good plan to issue only common stock. Even though profits may be made from the very beginning, it is often desirable to use those profits in the expansion of the business. If preferred stock is issued, the corporation is under an obligation to pay the specified dividend. If the company begins business with common stock and later finds it desirable to expand the business, it may then issue preferred stock in order to induce others to invest in the company.

Par-Value and No Par-Value Stock. In many states, corporations have the privilege of issuing par-value stock or no par-value stock. Illustration No. 14 (page 52) shows a certificate for no par value stock, Illustration No. 15 (page 54), a certificate for par-value stock.

Each certificate of stock must show the number of shares that it represents. If the stock has a par value, the certificate must indicate that value. The par value of a share may be almost any amount but it is usually \$100, \$50 or \$10. Many corporations prefer to issue stock with a low par value such as \$10 in order that they may induce a large number of small investors to buy the stock. For example, if stock sold at \$1,000 a share, there would be fewer people who could buy it than if the stock sold for \$10 a share. With a large number of people owning stock in a company, there should be many "boosters" for that.

company. But, on the other hand, a large number of stockholders will mean more clerical work in keeping the records of the various stockholders, in sending out many more notices of stockholders' meetings, in computing dividends and in writing dividend checks

Dividends on par value stock may be declared in terms of a percentage of the par value but they are required by most stock exchanges to be specified as a certain amount on each share. Dividends on no par-value stock are always quoted as a certain amount a share

The value indicated on a stock certificate should not be confused with the *market value*, which is the value at which the stock is bought and sold on the stock exchanges. A share of a certain stock may have a par value of \$50 but because the company that issued it has been prosperous and has been paying large dividends, certain people may be willing to pay \$60 for it. If a corporation has not been successful financially, the market value of its stock is likely to be less than the par value

No par-value stock is essentially the same as par-value stock, except that the former bears no statement that professes to indicate its value at the time it is issued. Its use avoids the inference of a specific value

Another term, *book value*, is often used in connection with the value of a share of stock. The book value of a share is found by dividing the net worth (stock outstanding plus undivided profits) of the corporation by the total number of shares outstanding. Thus, if the net worth of a corporation is \$75,000 and the number of shares of stock outstanding is 1,000, the book value of each share is \$75, regardless of whether the stock has a par value of \$50 or \$100, or whether it has no par value

Corporate Bonds. Illustration No 16 shows another means by which a corporation may obtain additional money. By reading the face of this corporation bond, you will see that the bond is a written promise to pay a definite sum of money at a specified time. It also contains an agreement to pay interest at a specified rate at certain in-



Illustration No 16—Coupon Bond

Intervals Bonds do not represent a share in the ownership of the corporation, they are evidence of a debt owed by the corporation. All bondholders have a preferred claim against the earnings of the corporation, for they must be paid before stockholders share in the earnings.

There are two general types of bonds (a) *mortgage bonds* and (b) *income, or debenture, bonds*. The issuer of

mortgage bonds pledges some specific assets as a guarantee that the interest and the principal will be paid according to the terms specified in the bonds. The assets that are commonly used as security for such bonds are land, buildings, or machinery. Debenture bonds have no specific assets behind them. They are secured by the faith and the credit of the corporation that issues them. Public corporations, such as city, state, and Federal governments, usually issue debenture bonds when they need to borrow money. Private corporations usually find it difficult to sell debenture bonds, although they probably prefer to issue debenture bonds instead of mortgage bonds. If the latter type is issued and the corporation is unable to meet some of the interest payments as they fall due, the bondholders may start foreclosure proceedings against the corporation. Such proceedings are usually instituted through the trustee of the bondholders. The trustee is ordinarily a bank that holds the mortgage representing the security for the mortgage bonds.

There are two general forms of bonds: (a) *coupon bonds* and (b) *registered bonds*. As coupon bonds are generally payable to the bearers, the corporation that issues them has no way of knowing who are the owners at the time interest payments are due. Because of this fact, coupons, one for each interest-due date, are attached to such a bond. The owner of the bond may collect the interest by clipping off a coupon and cashing it at the office of the corporation or at a bank on or after the date specified. For example, the interest on the coupon bond illustrated is payable on June 1 at the Chase National Bank, of New York. The coupon may be presented at this bank for payment, or it may be given to any other bank for collection. If the owner of the bond lives in Buffalo, he may turn the coupon over to his local bank for collection from the bank in New York. The bank in Buffalo will charge a fee to the owner of the bond. The corporation that issued the bonds will settle with the Chase National Bank, of New York.

If registered bonds are issued, the corporation keeps a record of each owner and pays the interest and the prin-

capital by check to the registered owner. This type of bond means more clerical work for the corporation, but it is preferred by many people who buy bonds.

Sometimes *convertible bonds* are issued. The holder of such bonds has the privilege of exchanging them for a definite number of shares of stock. This feature is attractive to the holder. He receives a fixed rate of interest as long as he holds the bonds, and later, if the corporation should begin to earn large profits and to pay large dividends, he may exchange the bonds for stock and begin receiving dividends instead of interest.

Expansion of a Corporation. Davis, Baker, and Miller, Inc., decide to carry out their original plan to expand the business by buying the land and the buildings for two additional stores. They have investigated carefully the stores that they wish to buy. They find that the two stores can be bought for \$30,000, which they believe is a fair price. They are now confronted with the problem of raising sufficient capital to make the purchase and add \$10,000 to the cash operating fund. Although they realize that they will have to pay a higher rate of earnings on preferred stock than they would on bonds, they decide to sell preferred stock, for it will place on them no obligation to repay to the stockholders the original amount of the investment. If they were to issue bonds, however, the bondholders would at a specified time have to be repaid the principal of their investment. If business conditions were to continue to be good, the bonds could probably be paid off easily, but if business conditions were to become unfavorable, the corporation might not be able to pay the principal of the bonds. The issuing of preferred stock is therefore the more advisable procedure.

The officers of the corporation obtain permission from the secretary of state to issue \$40,000 worth of preferred stock with a fixed dividend rate of 7 per cent a year. The stock is offered for sale at \$100 a share. The officers succeed in selling only 110 shares of the stock, which bring them only \$11,000 in cash. They therefore decide that their

only alternative is to issue bonds. They obtain permission from the secretary of state to issue \$30,000 worth of bonds in denominations of \$100 with interest at 6 per cent a year. The corporation closes the sale after selling \$29,000 worth of bonds at the par value. With the proceeds from these sales it purchases the two stores. The financial statement of the corporation then appears as follows. (It is assumed that no time has elapsed between the date on which the previous statement was prepared and the date on which the following statement was prepared.)

ASSETS		CLAIMS AGAINST ASSETS	
Cash	\$15 800	Accounts Payable (Debts)	\$ 800
Merchandise	11 500	Bonds Payable	29 000
Equipment	10 000	Preferred Stock	11 000
Land and Buildings	46 500	Common Stock	39 000
		Undivided Profits (Surplus)	4 000
Total Assets	\$83 800	Total Claims Against Assets	\$83 800

A more conservative procedure for this corporation would have been to rent the store buildings. If funds were then needed to buy additional merchandise and equipment, and the officers did not wish to obtain a short-time loan from the bank, the corporation could have issued the preferred stock and the bonds.

Suppose that, at the end of another fiscal period, the financial statement of the corporation appears as follows:

ASSETS		CLAIMS AGAINST ASSETS	
Cash	\$18 500	Accounts Payable (Debts)	\$ 500
Merchandise	13 000	Bonds Payable	29 000
Equipment	12 500	Preferred Stock	11 000
Land and Buildings	46 000	Common Stock	39 000
		Undivided Profits (Surplus)	10 500
Total Assets	\$90 000	Total Claims Against Assets	\$90 000

The directors declare and pay the 7 per cent dividend on the preferred stock. This payment reduces the cash by \$770 and the undivided profits by a like amount. A 6 per

cent dividend is also declared and paid on the common stock. This dividend reduces the cash by \$2,340 and the undivided profits by the same amount. A financial statement prepared at this time appears as follows:

ASSETS		CLAIMS AGAINST ASSETS	
Cash	\$15 390	Accounts Payable (Debts)	\$ 500
Merchandise	13 000	Bonds Payable	29 000
Equipment	12 500	Preferred Stock	11 000
Land and Buildings	46 000	Common Stock	39 000
		Undivided Profits (Surplus)	7 390
Total Assets	\$86 890	Total Claims Against Assets	\$86 890

Advantages of the Corporation The corporation has a number of advantages as compared with the sole proprietorship and the partnership. Some of these are:

- 1 Except in a few cases the owners (stockholders) are not legally liable for the debts of the corporation beyond their investments in the stock. Thus persons, whether they have only a few dollars to invest or whether they have thousands of dollars, may invest in a corporation without incurring a liability.
- 2 The corporation is a more permanent type of organization than the sole proprietorship or the partnership. It may continue to operate as long as the term stated in the charter, without danger of interruption because of the death of an owner or because of other changes in the ownership.
- 3 The corporation can accumulate money from several sources. This advantage makes possible large scale business operations and the hiring of expert management.
- 4 It is easy to transfer ownership in a corporation. A stockholder may sell his stock to another person and transfer the stock certificate which represents the ownership to the latter. When shares are transferred the transfer of ownership is indicated in the records of the corporation and a new certificate is made out in the name of the new stockholder.

- 5 A corporation may be able to attract a large number of stockholders, who, in turn, will help to advertise the *business* and will recommend its products or services

Disadvantages of the Corporation. Although we have seen that there are several distinct advantages to the corporation, there are also a number of disadvantages. Some of the most significant disadvantages are

- 1 A corporation is permitted to engage only in those activities that are specified in its charter. Should Davis, Baker, and Miller, Inc., wish to add to their business a department selling hardware, they would be unable to do so unless they went through the legal formality of obtaining a new charter. As a partnership they could have added the other department without governmental consent, provided the expansion was agreeable to all the partners.
- 2 A corporation cannot do business wherever it pleases. Davis, Baker, and Miller, Inc., are granted permission to conduct their business only in the state of New York. Should they wish to do business in adjoining states, they would probably be required to obtain in each state a license as a foreign corporation and to pay a fee for the privilege of doing business in the state.
- 3 A corporation must make special reports to the state from which it obtained its charter, as well as to other states in which it may be doing business. There is consequently an increased need for detailed financial records and reports.
- 4 Large corporations are seldom managed by men who take the personal interest of a sole proprietor or a partner. Stockholders who own only a few shares ordinarily are not interested personally in the management of the corporation. The corporation is therefore managed largely by a small group of stockholders.
- 5 The corporation is usually subjected to more taxes than are imposed on the sole proprietorship and the

partnership. Some taxes that are special to the corporation are: a *filing fee*, which is payable on application for a charter, an organization tax, which is based on the amount of authorized capital stock, an annual state franchise tax, which is usually based upon the profits, a Federal income tax. The first three of these vary in the different states.

- 6 The regulation of corporations by states and by the Federal Government is becoming more strict and burdensome.
- 7 Large corporations that have many stockholders have an added expense in the great amount of clerical work required, particularly in keeping the records of stockholders and in paying dividends.

Types of Businesses Organized as Corporations. A survey of businesses would show that almost every kind of business may exist as a corporation, but there are two particular kinds that are generally organized as corporations.

- 1, Those businesses that require large amounts of capital, such as railroads, companies that supply power and electricity for large cities, automobile manufacturing concerns, iron and steel manufacturing industries, large hotels, and office buildings.
- 2 Those businesses that have uncertain futures, such as amusement parks, makers of amusement devices, publishers of new magazines, and manufacturers of novelty articles. Persons who organize these types of businesses do not wish to assume the additional risk that falls upon a sole proprietor or a partner in case of failure of the business.

- 9 The officer of a corporation who makes a contract for the corporation is personally responsible true false
- 10 It is easy to transfer ownerships in a corporation true false

Multiple-Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement. The first is given as a sample

- 0 A registered bond gets its name from the fact that (a) it is registered in the state capitol (b) it is registered by the Federal government (c) interest and principal are paid to the owner registered on the books of the corporation (c)
- 11 Those who are responsible for the active management of a corporation are the (a) stockholders (b) bondholders (c) officers ()
- 12 A corporation stockholder a proxy is (a) a certificate for the transfer of stock (b) a vote on corporation affairs (c) a written authorization for someone to vote in behalf of the stockholder signing the proxy ()
- 13 A closed corporation is one that (a) has been closed because of bankruptcy (b) does not offer its securities for public sale (c) has such a demand for its stock on the open market that there are no shares available ()
- 14 One who owns a stock certificate of a corporation is (a) a creditor of the corporation (b) a part owner of the corporation (c) a partner ()
- 15 Generally speaking common stockholders are entitled to (a) share profits after preferred stockholders are paid (b) share profits before preferred stockholders are paid (c) receive no profits ()
- 16 Generally speaking preferred stock is (a) preferred because of its price (b) preferred as to dividends (c) preferred because of exemption from taxes ()
- 17 If there are any profits those who must be paid first are (a) common stockholders (b) preferred stockholders (c) bondholders ()
- 18 If the preferred stockholders share in excess earnings under a predetermined plan the preferred stock is called (a) participating (b) nonparticipating (c) noncumulative ()
- 19 The interest on coupon bonds is generally payable to (a) the registered owner (b) the bank (c) the bearer ()

- 20 A business ordinarily organized as a corporation is
 (a) an automobile manufacturing plant (b) a grocery
 store (c) a garage ()

PRACTICAL PROBLEMS

(Chapter III)

Complete the following problems. If you are doubtful about decisions reread the chapter. After you have completed the exercise you will find suggested solutions on page 303 of this book. If your answers do not follow the suggested solutions restudy your text then write your answers again.

- 3A In the financial statement of the partnership of Davis Baker and Miller on page 37 there is an item of \$4 000 of undivided profits. If these profits are distributed (a) how much will each partner get and (b) how will the financial statement appear after the distribution?
- 3B Assume that in the partnership of Taylor & Williams the capital of Taylor is \$15 000 and the capital of Williams \$10 000. How should \$3 500 of profits be divided if earnings are distributed in proportion to the capital of the partners?
- 3C Suppose that in the partnership of Davis Baker and Miller the death of Mr. Miller occurs on May 1 of a certain year. Referring to Article Nine in the articles of copartnership on page 36 state how the profit of \$3 600 for the entire fiscal year ending on the next January 31 should be divided.
- 3D By referring to the following balance sheet answer the questions given below.

THE EMPIRE CORPORATION BALANCE SHEET

ASSETS		LIABILITIES AND CAPITAL	
Cash	\$15 500	Accounts Payable	\$ 2 000
Accounts Receivable	5 000	6% Bonds Payable	20 000
Merchandise	20 000	Common Stock	
Equipment	4 500	Authorized	\$50 000
Real Estate	45 000	Unissued	10 000
		Outstanding	40 000
		7% Preferred Stock	
		Authorized	\$30 000
		Unissued	30 000
		Outstanding	20 000
		Undivided Profits (Surplus)	8 000
Total Assets	<u>\$90 000</u>	Total Liab and Capital	<u>\$90 000</u>

- (a) What was the organization tax if the rate was 50 cents on each \$1 000 of authorized capital stock?

- (b) If the par value of each kind of stock is \$50 how many shares of each kind are outstanding?
- (c) What is the book value of each share of stock?
- (d) If the directors decide to distribute \$3 400 as dividends how much will be paid to the common stockholders and to the preferred stockholders? How much should Mr Goodman receive if he owns 10 shares of common stock and 25 shares of preferred stock?
- (e) Suppose that the preferred stock is cumulative and that the corporation was unable to pay any dividends last year How should \$6 000 of undivided profits be divided?

CORRESPONDENCE AND DISCUSSION PROBLEMS

(Chapters I, II, and III)

If you are a regularly enrolled student in the United States Armed Forces Institute you are entitled to assistance from an instructor by correspondence if you wish such assistance These problems are for that purpose However you are not obligated to send in these assignments If you want suggestions on your work write out your answers to these assignments and send them to the United States Armed Forces Institute as instructed on page v of this book.

If you are working in a class under an instructor the assignments may be used for discussion or for written outside work.

- 1 Are large businesses more efficient than small ones?
- 2 Instead of trying to think of some novel idea or invention for a business suggest a sound basis for a new business
- 3 Is it possible to determine precisely the existing phase of the business cycle?
- 4 What is the danger of investing money in a building when a business is being organized?
- 5 What is turnover and how does it affect the profitability and the working capital of a business?
- 6 How is a partnership affected when a partner withdraws from the business?
- 7 If a partnership that fails and ceases operations is unable to pay all its debts what may the creditors do?
- 8 If an investor does not care to participate in the management of a business which is the more satisfactory type of organization in which to invest his money a partnership or a corporation? Why?
- 9 Does the par value of a stock indicate its real value?

CHAPTER IV

PROBLEMS OF SELECTING A BUSINESS LOCATION

Purpose of the Chapter The location of a business in most cases is an important factor in determining whether the business will be a success or a failure. The discussion in this chapter will answer many questions with regard to location some of which are

- 1 What are the ways of selecting a good location?
- 2 What are the possibilities of particular locations?
- 3 How do automobile and pedestrian traffic affect locations?
- 4 What are some of the common errors in selecting locations?
- 5 What are some of the factors that affect the location of manufacturing industries?

Importance of Selecting the Proper Location Selecting a location should not be a matter of guesswork. The proper location is frequently the factor that determines the success of a business. The United States Department of Commerce has conducted studies that disclose the importance of the proper location of stores. Some types of businesses do well in one kind of location whereas other types would not succeed in such a location. Some of the large chain store organizations have a special department that selects the locations for stores. Some companies have found that the elimination of unprofitable stores and the relocation of the remaining stores increase sales and thereby increase profits. What is true for a company that operates several stores is true for the business that consists of only one store that is each location must be studied as a distinct problem.

Selecting a Location As transportation facilities improve businesses tend to congregate. There was a time when single stores were common in rural districts. Al

though such stores may still be found, they are gradually clustering together in small communities because of the improvements in transportation facilities. As a result of the use of the automobile, people in a rural community ride to a larger town to buy instead of patronizing a neighboring store. One who contemplates operating a store in a small town must recognize the fact that some of the customers will prefer to go to larger communities for their important purchases. The success of a store will, to a large extent, depend upon the owner's ability to interpret the particular wants of the people in the surrounding community, to fill those wants, and to encourage the people to buy at home. In other words, a good merchant is one who serves as a good purchasing agent for the people whom he serves.

In cities, stores congregate in groups, forming what are commonly known as *shopping centers*. Neighborhood stores and neighborhood garages are still common, but such businesses are usually fairly well concentrated in location. A shopping center that includes a dry-cleaning establishment, a drugstore, a meat market, two grocery stores, a garage, a barber shop, an electric supplies shop, a beauty parlor, and a motion-picture theater is reasonably well balanced. If it included four drugstores, however, instead of one, it would not be a particularly attractive business location for a new drugstore. While there are advantages in congregation, there may be a disadvantage because of too much competition in one particular type of enterprise.

Downtown locations in cities are good for department stores, hotels, restaurants and parking lots. Large complete food stores are also commonly found in the downtown sections of cities. Such a section can support, however, only a limited number of grocery stores and meat markets. These accommodate the people who live in this part of the city and some who buy on their way home. The average town or city can support only a few fresh produce markets where merchants and farmers congregate to sell their products. These naturally must be located in some central downtown area to be accessible from all parts of the city.

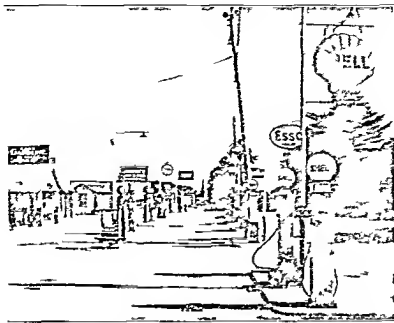


Illustration No 17 There Is Too Much Competition
in Some Locations

Downtown locations are ordinarily preferred for the sale of products that are not purchased so frequently as food products. The purchase of furniture for instance is sufficiently important for the customer to be willing to make a special trip. Many housewives however prefer to buy food supplies near their homes and thus to save time.

Corner locations have the advantages of accessibility and effective display but they usually cost more than others.

The manufacturer has problems of location that are distinct from those of the merchant. His market is not always close to him. In fact he frequently serves a wide area whereas the retailer serves a relatively restricted area.

The person who sets up a simple roadside stand must follow an intelligent plan of selection if he expects to be successful. For instance he must consider (a) the amount of traffic that passes the location (b) the type of traffic (c) the habits of the people with regard to buying from



By Evelyn Quilley N 1

Illustration No 18—A Roadside Stand Must Be Convenient

roadside stands, (d) the convenience of location for stopping and parking, (e) the appearance of the stand, (f) the location with respect to a large community, and (g) the location with respect to competitors. If a desirable location has been selected, the success of the roadside stand will depend upon practices of courtesy, honesty, efficient service, and good quality. Such an enterprise usually thrives upon a good reputation, but fails upon a bad one.

Selecting a location for a manufacturing enterprise is quite a complicated procedure if it is done scientifically. Such an enterprise must consider carefully such factors

as (a) the extent of the market (b) the location of the market, (c) labor conditions, (d) the supply of proper labor, (e) the sources of materials, (f) transportation costs (g) transportation facilities and (h) production facilities and costs. Several locations should be compared with a view to selecting the proper one.

Estimating the Prospects of the Location. In addition to the transportation facilities, zones, and other factors, the population of the particular community should be studied to find the location of customers. For example, Illustration No. 19 on page 74 provides some information about the characteristics of a community. A study of census figures, local welfare figures, statistics from the United States Department of Commerce, and information from the local chamber of commerce will frequently disclose the characteristics of the community. Chain store organizations make these studies in a scientific manner. One chain-store organization covers the following factors in its study of store locations:

- 1 Age and sex of the prospective customers
- 2 Habits of the prospective customers
- 3 Racial characteristics
- 4 Conveniences demanded
- 5 Needs of the people
- 6 Occupations of the people

Influence of Traffic on the Location of Stores. The traffic problem is a serious one for stores. Merchants have found that a scarcity of parking facilities discourages shopping, for people often buy at stores that can be reached easily. Some merchants have found it profitable to provide free parking space for customers or to make arrangements with the managers of garages and parking lots to reduce rates for the customers of the stores. Some stores that are not located in the shopping district provide special transportation facilities, such as busses. If all merchants in the same kind of business provide similar service, no merchant gains any particular advantage, but all gain some advantage because shopping has been made easier. Nevertheless, the

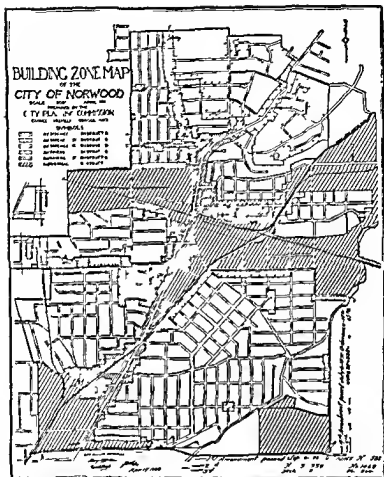


Illustration No 19—A Typical Zoning Map

cost of the added service must be included in the selling price of the merchandise

Another important aspect of traffic has to do with what is called the *traffic count*. This term refers to the number of vehicles or the number of people that pass a specific location. Real estate firms, large stores, and chain store organizations conduct traffic counts to determine the relative values of different locations. For example, if a person

is considering two locations for a women's shoe store he may have a traffic count made of each location. If the traffic count shows that three hundred women pass one location in an average day whereas five hundred pass the other location during the same time the latter is to be considered the better location. If a count of automobile traffic were made it might show that one hundred women pass the first location in automobiles during an average day whereas only fifty pass the second location. The latter would still be considered the better location because the number of people who walk by a store is more important than the number who ride by.

A high automobile traffic count is more important if there are parking facilities in the immediate vicinity than it is if there are no parking facilities. Many people may pass a location in automobiles but if they cannot stop and park their cars the location has no particular advantage from the point of view of shopping although it does have an advantage from the point of view of publicity. The traffic count of automobiles is of course more important than the pedestrian count in the case of determining a location for a garage or a filling station.

What Is a Good Location? The rent to be paid for a location should have a satisfactory ratio to the anticipated sales volume. The tables in Chapter V show satisfactory ratios. As good locations usually have high rents rent should be considered only as a percentage of the anticipated sales volume. In other words a location that is poor requires only a low rent because the anticipated sales volume in such a location will be lower than it would be in a better location.

In comparing one business location with another it is necessary to consider other factors. If automobile parking lots are near people can park their cars and shop conveniently. A location near apartment buildings should be favorable for a food store. Locations near bus terminals should be favorable for restaurants. Grocery stores, meat markets, and drugstores attract customers to a shopping

center. Such a shopping center should therefore be favorable for a hardware store

An automobile sales district is ordinarily not a satisfactory location for a retail store. A location near public buildings or in a manufacturing district is not favorable for such a store because it is inconvenient to large numbers of potential customers

Sometimes one side of a street may be a good location whereas the other side may be undesirable. For instance the character of the businesses on one side of a street may attract certain types of customers. The sunshine on one side of a street may be so hot in the summer that people will walk on the shady side. One side of a street often has more pedestrian traffic than the other and may therefore be a better location for certain types of businesses

Some Common Errors in the Location of Stores When people go into a retail business or when retail merchants change their location, they frequently make mistakes. Some of the most serious mistakes are

- 1 The retailer is influenced too much by vacant space and low rent, and the expectation that customers will come to him. He bases the selection of his location on cost rather than on suitability. His business consequently fails because it is located where too few customers pass
- 2 The fact that several stores are already located in a section encourages the retailer to select the same location. The volume of business available in this section is not sufficient, however, to support all the merchants there
- 3 The location may be suitable for one type of business but unsuitable for another

Fitting into the Community. In studying the suitability of a location, the retail merchant should give careful consideration to the type of community. There is a general tendency for all merchants to improve the appearance of their stores. It is natural, however, to expect a store in a

better residential section to be more modern and better equipped than a store in a neighborhood in which the people are interested mainly in obtaining the most value for their money. These factors of location will govern the decoration of the front and the interior the arrangement and display of the merchandise and the types of service offered. Well-to-do customers are frequently willing to pay a little extra in order to have their merchandise delivered, whereas persons in meager circumstances are not willing to pay for this extra service.

Regional Markets A business can expand within certain limits set by competition financial support economy in distribution and efficiency in service. Many businesses that operate in local markets eventually extend into regional markets that take in more than one state. For instance some ice-cream manufacturers expand from one city to another until they cover a regional market such as New England, the Ohio Valley or the West Coast. Seldom, however, does an ice-cream manufacturer extend marketing into a particularly large area. Some candy manufacturers who start as small enterprises eventually expand into regional markets and a few of these expand into national markets. Numerous food products as well as other products are sold in regional markets but often no attempt is ever made to market them nationally.

SELF-CHECKING STUDY QUESTIONS

(Chapter IV)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer reread the chapter until you find the correct answer then compare your answers with those on page 99 of this book. Refer to the printed answers only after you have made a serious effort to answer all questions for otherwise the questions will not be of greatest value to you. If you have any incorrect answers reread the part of the chapter in which those questions are discussed.

True-False Questions

Directions After each statement below that is true, draw a line under "true." After each statement that is false, draw a line under "false." The first statement is given as a sample.

0. Selecting a good location is guesswork true false
1. Improvement in transportation in a particular location causes businesses to congregate true false
2. The increased use of automobiles has improved the status of the crossroad country store..... true false
3. A small shopping center which includes one dry-cleaning establishment, one drugstore, one meat market, two grocery stores, one garage, one barber shop, and one electric supply shop can also support one or two additional drugstores true false
4. If a merchant expects to be successful, he must serve as a careful purchasing agent for his customers true false
5. It is better to pick an isolated location for any business than to select a location in an established community shopping center true false
6. The convenience for stopping and parking is important in establishing a roadside stand ... true false
7. It is sometimes advantageous for two businesses of the same kind to be located close together.... true false
8. A corner location may be desirable because it provides additional window display space true false
9. A business which pays the lowest rent can usually sell at the lowest prices true false
10. A district in a city in which several automobile salesrooms are congregated is also a good location for a retail grocery store true false

Multiple-Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement. The first is given as a sample.

0. One side of a street may be a better location than the other side because (a) it is shady in summertime, (b) it is closer to a bank, (c) the rent is higher (a)
11. The shifting from buying in country stores to buying in towns and cities has been brought about largely by (a) lower prices, (b) the automobile, (c) government regulations ()

- 12 One of the principal errors in selecting a location is (a) the inducement of low rent (b) getting too much space (c) getting too little space ()
- 13 The rent for a location in a congested downtown area is higher than in outlying districts of the city because (a) there are more amusements (b) taxes are higher (c) the owner can demand more because there are more customers ()
- 14 A good place for the location of a general restaurant is (a) in a residential section (b) near a bus terminal (c) near a municipal golf course ()
- 15 A good location for a hardware store is (a) at the edge of town (b) near a school (c) near other retail stores such as groceries ()

PRACTICAL PROBLEMS

(Chapter IV)

Complete the following problems. If you are doubtful about decisions reread the chapter. After you have completed the exercises you will find suggested solutions on page 303 of this book. You cannot expect that your answers will be exactly the same as those which are suggested but if your answers do not follow in general the suggested solutions restudy your text then write your answers again.

- 4A. Select what you consider to be a good location in the community in which you formerly lived or one with which you are familiar. Draw a sketch of the stores and mark your selected location on the sketch. Study the type of business for which you think the location is suitable and list the reasons why you think so.
- 4B. From your familiarity with your own home town or another community make a map of the business district or a shopping center. Mark on the stores by codes or letters the identification of the various types of businesses located there. Then comment on what you consider to be a satisfactory or an unsatisfactory concentration or placement of these businesses.
- 4C. From your knowledge of a particular business or industry in your community or in a community with which you are familiar write a report giving the logical reasons why the industry is located where it is. Indicate also its disadvantages. If you know of another location that would be better indicate that location and give your reasons.

CHAPTER V

PROBLEMS OF OBTAINING HOUSING FACILITIES

Purpose of the Chapter. Obtaining satisfactory housing facilities for a business may involve buying, leasing, or renting a building, constructing a new building, renting or leasing space in a building, or leasing a department in a store. Many of the problems of acquiring housing facilities are discussed in this chapter. Some of the important questions that are answered are

- 1 How much can a business afford to spend for housing facilities?
- 2 Is it more desirable for a person starting in business to lease or to buy the necessary building?
- 3 What are the principal legal points in connection with leasing property?
- 4 What are some types of lease contracts?
- 5 What things should be investigated before buying a building?

How Much to Spend for Housing Facilities. As one of the large operating costs in most businesses is the cost of providing proper housing facilities, the prudent business man must determine how much he can afford to pay. The amount that can be safely spent for space to house a business will depend upon how much profit can be made from operating the business in that location. The factors that influence the cost of rent were discussed in a preceding chapter. Rent is charged largely on the basis of the demand for the property. Obviously, therefore, rents in downtown sections are higher than those in outlying areas of the city. The rent for a location in a small town is usually lower than the rent for a similar location in a larger city. The rent for a building on a rural road, however, is less than that for a similar building in a small town.

A study made by the United States Department of Commerce in a typical large city discloses that some types of businesses can be operated more profitably in the central shopping district than they can in locations outside this district. The central shopping district is considered to be the heart of the city—that is the place where buildings are concentrated and traffic is congested. This is also the place where rents are highest because more people who are potential customers pass locations in this part of the city than locations in other sections.

The results of the study made by the Department of Commerce are shown in Illustration No. 20. This table indicates the percentage of sales that each type of store spent for rent in each location. Notice for example, that candy and confectionery stores found it cheaper to operate

Kind of Business	Percentage of Sales Spent for Rent	
	Stores Located in Central Shopping District	Stores Located in Other Parts of City
Candy and confectionery stores	5.5	10.7
Fruit and vegetable stores	28.7	6.4
Department stores	2.8	3.7
Dry goods stores	9.8	6.0
Variety stores (\$5-10¢-\$1)	6.2	6.5
Automobile accessories stores	4.1	4.6
Men's clothing stores	5.8	6.9
Men's specialty shops	14.7	8.0
Family clothing stores	4.9	2.9
Dressmaking establishments	6.7	9.7
Men's shoe stores	11.7	4.6
Women's shoe stores	10.6	8.9
Furniture stores	4.0	5.1
Household appliance stores	5.0	3.7
Radio shops	5.9	3.3

Illustration No. 20—Percentage of Sales Spent for Rent in Different Parts of a Typical City

in the central shopping district than they did in other locations. Men's specialty shops found it more expensive to operate in the central shopping district, whereas men's clothing stores found rent less expensive there.

Leasing Rather than Buying Seldom will a person starting in business want to buy a piece of property. In the first place, he should be careful to have available for operating purposes as much cash as possible. If he invests his cash in a building, he may later run into difficulty through a lack of funds. When a person starts into business it is rather difficult to anticipate exactly the needs of the business. Furthermore, he may buy a building in the wrong location or one that is too small or too large. If he leases or rents, he can rectify a mistake in a reasonably short time and without any great cost.

Relations of Landlord and Tenant. When a person allows his property to be occupied and controlled by another, he is called a *landlord*. The one who occupies the property with the consent of the landlord is the *tenant*. Although the tenant has possession of the property, he has certain duties and obligations with respect to the rights of the landlord. These are explained later. After the expiration of the agreement the landlord has the right to regain possession of the property.

Explanation of Tenancy. The agreement between the landlord and the tenant is known as a *lease*. The landlord is the *lessor*, and the tenant is the *lessee*. Unless there is a law prescribing that a lease must be written, the lease may be oral. In all cases, however, it should be written in order to avoid any misunderstanding. A written lease is desirable in many cases because it clearly defines the rights of the landlord and those of the tenant. As will be seen later, the period of occupancy may be definite or indefinite. In some states the lessor and the lessee must sign their names before a witness, such as a notary public.

The lessor grants the lessee the privilege of using the property for lawful purposes and without interference, provided the terms of the contract are properly carried out. The lease states specifically the rights of each party to the contract. A typical lease is shown in Illustration No. 21. Some of the particular rights of the lessee and the lessor are mentioned later in this chapter.

This Lease Witnesseth:

THAT Harry F. Warner

HENRY LEASE TO James A. Barnet

the premises situate in the City of Lincoln in the County of Lancaster and State of Nebraska described as follows:

Store Building, No. 732 Highland Avenue, Lincoln, Nebraska

with the appurtenances thereto, for the term of ten years commencing

March 1 1914 at a rental of sixty

dollars per month, payable monthly.

Said Lessee Agrees to pay said rent unless said premises shall be destroyed or rendered untenable by fire or other unavoidable accident or not commit or suffer waste to not use said premises for any unlawful purpose to not assign this lease or underlet said premises or any part thereof, or permit the sale of his interest herein by legal process without the written consent of said lessor to not use said premises or any part thereof in violation of any law relating to intoxicating liquors, and at the expiration of this lease to surrender said premises in as good condition as they now are, or may be put by said lessor reasonable wear and unavoidable casualties condemnation or appropriation excepted. Upon non payment of any of said rent for ten days after it shall become due and without demand made therefor or if said lessor or any assignee of this lease shall make an assignment for the benefit of his creditors or if proceedings in bankruptcy shall be initiated by or against lessor or any assignee or if a receiver or trustee be appointed for the property of lessor or any assignee or if this lease by operation of law pass to any person or persons or if said lessor or any assignee shall fail to keep any of the other covenants of this lease, it shall be lawful for said lessor, his heirs or assigns, his said premises to re-enter and the same to have again re-possession and enjoy as in his first and former estate and thereupon this lease and everything herein contained on the said lease shall be void and performed shall cease, determine and be utterly void.

Said Lessee Agrees (said lessor having performed his obligations under this lease) that said lessee shall quietly hold and occupy said premises during said term without any hindrance or molestation by said lessor, his heir or any person lawfully claiming under them.

Signed this first day of March A. D. 1914

IN PRESENCE OF:

<p><u>Walter S. Lange</u></p> <p><u>Louis M. Stevens</u></p> <p>_____</p> <p>_____</p>	<p><u>Harry F. Warner</u></p> <p><u>James A. Barnet</u></p> <p>_____</p> <p>_____</p>
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The formal type of lease usually embodies the following information

1. The date
- 2 The names of the landlord and the tenant
- 3 A description and an identification of the property
4. The length of the tenancy period
- 5 The amount of the payment
- 6 The manner of payment
- 7 A statement of the conditions and the agreements
- 8 The signatures of the tenant and the landlord

A tenant may occupy property as (a) a *tenant for years*, (b) a *tenant from year to year*, or (c) a *tenant at will*. A tenant for years occupies property under an agreement for a definite period. A tenant from year to year, like a tenant from month to month, occupies property under an agreement for an indefinite period. A tenant at will is one who occupies property for an indefinite period the agreement being terminable at will by either party. A tenancy at will is commonly referred to as *renting*. This term is a somewhat indefinite one that most people use in reference to the occupancy of property without a written contract.

Rights and Duties of the Tenant. The tenant of a piece of property is entitled to the peaceful possession of it. If he is deprived of that, he may recover damages through a lawsuit. The tenant is also entitled to use the property for any purpose for which it is adapted unless he is forbidden by the agreement. The wording of the lease should therefore cover the use of the property. Under no circumstances is the tenant allowed to use the property for unlawful purposes.

The tenant is under obligation to make minor repairs but not improvements. He must pay his rent when it is due. Unless the lease states otherwise, the rent is not due until the end of each month.

If the lease is for a definite period of time, the tenant is not obligated to give notice when he vacates the property. The lease may be terminated however, before the expiration of the period if an agreement is reached with the land

lord If the lease is for an indefinite period of time, the tenant must notify the landlord of his intention to give up the lease The form and the time of notice are regulated by the customs or the laws of the community in which the tenant is located The following is an example

Billings Montana
December 1 19—

Mr Andrew Walker

I hereby give you notice that I will quit and deliver possession January 1 19— of the premises at No 945 Hamilton Avenue in the city of Billings Montana which I now hold as tenant under you

Martin Arnold

Illustration No 22—Tenant's Notice of Intention to Terminate a Lease

The tenant should inspect carefully the property that he rents or leases In the absence of any agreement with the landlord, he accepts the property with the risk of any defects (except defects hidden by the landlord) that may be present In most states the tenant is liable for injuries to guests resulting from defects he should have remedied

Length of Lease. If one is starting into business, he should not lease for any longer than is absolutely necessary for his own protection In other words, he should not obligate himself so that he cannot move if he finds that he has made a mistake in the selection of the property or that the business is not going to be successful in its present location If he finds it necessary to move, he will not want to be obligated to pay on the original lease If the business fails, he will not want the obligation of a long lease

On the other hand, an established business can afford to take a longer lease In the first place, it is possible to determine the probable volume of business and amount of profit In the second place, previous experience will indicate the value of the location In times of anticipated increases in the value of real estate, it is advisable to arrange for a long lease In times of anticipated decreases in the value of real estate, it is advisable to arrange a short lease.

Lease with Privilege of Purchase. If a businessman is reasonably sure that he has found a desirable location that he may wish to buy later, it is sometimes advisable for him to lease the property with the privilege of purchase. Under such a contract the tenant may have the right at any time or at a specified time to obtain the property at a price agreed upon in the contract. In some cases part of the rent may apply as a down payment if the property is purchased. Such a plan is a more conservative one than an outright purchase. It at least gives the tenant an opportunity to be sure that the property is what he wants and needs. It also gives him an opportunity, if he does not have the money available to wait until the business has earned enough money for him to buy the property.

Percentage-Income Leases. Some rental leases are based upon a percentage of sales rather than upon a fixed price. In other words, the person who rents property agrees to pay to the owner a certain percentage of his sales. The theory of a percentage-income lease is that, if a business is not successful in a particular location the tenant should not be burdened with a high rate and the landlord is not entitled to such a rate. If the business is successful, the tenant can afford to pay a greater rent and the landlord is entitled to a larger amount. The following are the five general types of percentage leases:

- 1 **The minimum-maximum form.** This type of lease provides a minimum guaranteed rental and also specifies a fixed maximum rental that the owner may realize under any circumstances, no matter to what extent the volume of the tenant's business may grow. This type is rare and is considered to be neither equitable nor sound.
- 2 **No guarantee form.** This type carries a clause giving the owner the right to cancel the lease after a reasonable time if the tenant fails to accomplish the predetermined volume.
- 3 **Regular percentage form with minimum guarantee.** This is the most simple and common type.

- 4 A combination of fixed rental and percentage form in which a certain portion of the term calls for a regular rent and the balance of the term has a percentage basis with a minimum amount. This type actually amounts to two leases running consecutively one a *fixed rental form* the other a *percentage form*. This type is not common and few good reasons may be advanced for its use.
- 5 A flat percentage of net sales for an initial period followed by a minimum amount for the balance of the term.

Amount of Rent Paid under Percentage Income Leases

The percentage of his sales that a businessman pays under a percentage income lease depends upon the type of business and upon his success in negotiating a satisfactory lease. A percentage lease if the rate is reasonable is fair to the tenant and to the landlord. Under such a plan however it is advisable for the landlord to be sure that the tenant is the kind that will produce the greatest maximum income in the location.

The table in Illustration No. 23 shows the results of a study made in a large city to determine the percentage of income paid as rent under percentage income leases during a particular year.

Clauses in Percentage Income Leases The ordinary type of printed lease form is used in drafting a percentage lease. *This form stipulates the usual rights and duties of the landlord and the tenant* but also includes a clause stipulating the basis on which payments are to be made. The landlord usually also inserts some additional clauses for his own protection. The following are examples of those clauses.

- 1 A clause to the effect that the lessee shall not own, operate, become financially interested in, or lend any type of support to a store selling like merchandise within so many blocks of the location.
- 2 A clause whereby the lessee agrees to carry insurance on his life, the benefits from which are to accrue to

the lessor for rental payments applicable to the balance of the lease in the event of the lessee's death

- 3 A clause whereby the lessee agrees to carry and to display merchandise of a certain described type decided upon in advance as being proper, and further agrees to sell such merchandise at a price not in excess of that at which like products may be obtained

Type of Store	Percentage of Income Paid as Rent
Art goods and gifts	10%
Automobile parking lots—parking only	50%
Automobile parking lots—accessories (and 1 cent a gallon on gasoline)	15%
Automobile sales	5%
Bakery goods	7%
Barber shops—street	15%
Beauty shops—merchandise	10%
Beauty shops—service	15%
Books and stationery	8-10%
Books—secondhand	10-12%
Candy	10-12%
Cigars	8-10%
Drugs	8-10%
Flowers	8-10%
Furniture	5%
Furs	7-8%
Groceries	5%
Haberdasheries	10%
Hosiery	8-10%
Jewelry—quality and popular price	10%
Jewelry—novelty costume etc	12%
Linen	8-10%
Lingerie	10%
Liquor—packaged goods	6-8%
Men's clothing	7-8%
Men's hats	10-12½%
Millinery	12½ 15%
Optical goods	10-12½%
Paints—specialty goods	10%
Radios musical instruments etc	6%
Restaurants and taverns	8-10%
Shoes women's	8-10%
Shoes men's	8-10%
Shoe repair valet service etc	15-20%
Sporting goods	7 10%
Stationery (15 per cent on legal blanks)	10%
Trunks and leather goods	10%
Women's wearing apparel	8-10%

Illustration No 23—Percentage of Income Paid as Rent under Percentage Income Leases

4. A clause whereby the lessee agrees to expend a certain percentage of his gross annual sales for advertising in local newspapers, on the radio, and in other established advertising mediums
5. A clause whereby repossession of the property may be had by the landlord if the rent paid over a certain period has not averaged or equaled a certain amount.
6. A clause whereby the lessee agrees to operate his business continuously during certain set hours or at least during the hours generally considered to be those established for that type of business (This clause is particularly important in percentage leases for theaters)
7. Other clauses that may be inserted are a clause regarding use and occupancy insurance (explained in Chapter VII), a clause regulating the type of fixtures to be used in the storeroom, and a clause requiring the lessee to employ adequate help so that the maximum potential business may be taken care of. These clauses, however, are employed only in extreme cases

Escalator Clauses. Regular leases and percentage-income leases may contain so-called escalator clauses. For example, during the first year under an ordinary lease, a certain amount may be paid each month, during the second year and succeeding years the amount may be increased until a fixed maximum is reached. Likewise, percentage-income leases may require the tenant to pay 4 per cent on the first \$10 000 of sales, 5 per cent on the next \$10,000 of sales, and so on.

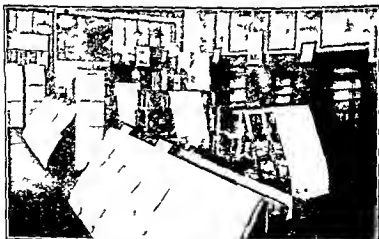
Subleasing. There is a common practice of subleasing business property. For example, a tenant may lease a piece of property and find later that it is not desirable or that it is not large enough. He may therefore sublease the property to another tenant and obtain for himself another piece of property.

It is desirable that the tenant have a lease contract that gives him the privilege of subleasing. It is equally desir-

able that the landlord be protected in such a case by some clause in the lease. In other words, the landlord will probably want to insert a clause prohibiting the tenant from subleasing the property without the approval of the landlord.

The subleasing of property constitutes an additional business risk. For example, if the businessman is working on a small margin and decides to sublease a piece of property and obtain another piece, there is a possibility that his tenant, the person to whom he has subleased, may go out of business and have to give up the property. The loss of this income may therefore be a serious handicap.

Department Leasing. One who is operating or contemplating operating a small retail store in a city may find it advantageous to arrange with some established store to lease a part of it. For example, one may be able to lease, from the owner of a grocery store, space for a meat department in that store. It is a common practice for department stores to lease departments. For instance, such a store may operate all its major departments but may sublease some of the others. Some department stores make



Biko Kunkler Company

Illustration No 24—A Leased Department

a practice of leasing most of their departments Those most commonly leased are as follows

Millinery	Wallpaper
Hair goods, hair dressing, and manicuring	Shoes
Crockery and glassware	Furs
Carpets and linoleum	Sewing machines
Furniture or house furnishings	Dress patterns
Optical goods	Men's clothing
Musical instruments	Cleaning and dyeing
	Restaurants
	Photographic

The lease arrangements of departments are quite similar to the agreement made between a businessman and any other landlord with the exception that the leased department operates, so far as the public is concerned, as an integral part of the store

Advantages and Disadvantages to the Department Lessee and Lessor. Among the principal advantages to the lessee of a department are

- 1 Obtaining a location in a developed market where a certain volume of trade is already waiting
- 2 Gaining the prestige of the lessor's name and goodwill
- 3 Receiving the advantages of the accounting and collection systems of the department store
- 4 Participating in giving his customers many store services that he would not be able to give if he were located in a separate building

Some of the disadvantages to this type of lessee are

- 1 The tenure may be impermanent. Often the lessor may terminate the contract on short notice
- 2 As there may be considerable demand for leased departments, the rentals may be high
- 3 The lessor controls the store policies

Leased departments have advantages and disadvantages also for the store, or lessor For instance, the store may have difficulty in controlling the policies and the conduct

of miscellaneous leased departments, as well as the quality and the appearance of the merchandise handled in those departments. On the other hand, the leasing of departments eliminates the problems of buying and merchandising for those departments.

One who leases a department should have a clear understanding of his rights and privileges. He should also have a definite knowledge of the customs and practices of the store. For example, if each department records its own sales and collects its own money, no particular problem is involved, but if charge accounts are handled through the store management, the department must depend upon the store for collections, returns, exchanges, and adjustments.

Rights and Duties of the Landlord. A landlord does not have a right to enter the premises of a tenant except to do what is necessary to protect the property. He must not interfere with the tenant's right of possession. If the tenant abandons the property, however, the landlord may take possession. At the expiration of the lease the landlord may enter the property and take possession through legal proceedings.

The landlord is entitled to receive the rent specified in the lease. In some states, through legal proceedings, he may seize the tenant's personal property and have it sold to pay the rent that is in arrears.

In some states the landlord is under no obligation to make repairs or to pay for improvements on the property unless an agreement has been made with the tenant. In most states, however, he is obligated to keep the building in habitable condition. Unless the lease specifies otherwise, taxes and assessments must be paid by the landlord.

When a tenant occupies property for an indefinite period of time, the landlord may obtain possession of it by giving notice. The form and the time of the notice are regulated by local customs or laws. Illustration No. 25 is, however, a typical notice from a landlord.

When the landlord retains control over a part of the property, as in the case of a landlord who leases part of

a building to a tenant he is liable for certain injuries that may be caused by the defective condition of the part of the property over which he has control. For instance Mr A owns a store building and rents part of it to Mr B. Mr B and his customers must pass through a section of the building controlled by Mr A. Should any injuries occur to Mr B or to his customers as they are passing through Mr A's part of the building Mr A may be liable for damages.

Alterations and Fixtures The tenant or the landlord may agree to make alterations or to install fixtures. It is more customary however for the landlord to make the alterations and for the tenant to install fixtures. The lease should cover these provisions very specifically.

Guides in Buying Property It was pointed out previously that it is usually undesirable for a man starting in business to purchase a building or buildings to house his business. Sometimes a businessman may be unable to lease a suitable building or after operating for a while in leased property he may decide that it is more desirable to buy than to continue to lease. Should he decide to buy there are many things that must be considered. Some of them are discussed here.

Time to Buy A person cannot always choose the exact time at which it is most profitable to buy but if he keeps certain points in mind he will be able to make a good purchase. Generally real estate valuations are lowest near the end of business depressions when many real estate mortgages are being foreclosed; they are highest near the peak of the prosperity phase of the business cycle. Valuations are also likely to rise as the surrounding property begins to be developed and improved. Naturally the best time to buy is when valuations are low. It is difficult to determine the end of a depression. If a businessman wishes to buy real estate at the most opportune time however he should not buy it when prices are relatively high and many people are buying but should buy it when prices are low and few people are buying property.

- 0 A tenant for years occupies property under an agreement for a definite period true false
- 6 The percentage of sales spent for rent by candy stores is higher in central shopping districts than in other locations true false
- 7 The percentage of sales spent for rent by radio shops is higher in central shopping districts than in other locations true false
- 8 When starting in business, one should obtain as long a lease as possible true false
- 9 The theory of a percentage income lease is that the burden of rent should be reasonable and that if the business becomes successful in the location the landlord should be entitled to a larger amount true false
- 10 Subleasing a piece of property adds an additional business risk true false
- 11 A landlord may enter his property at any time true false
- 12 Ordinarily in the absence of any agreement to the contrary the tenant pays the taxes true false
- 13 Certain departments of a department store may be leased to independent operators true false
- 14 Twenty per cent of sales is a reasonable figure for an automobile accessory store to pay for rent true false
- 15 Leasing with the privilege of purchase is a more conservative policy than buying a building for a new business true false

Multiple Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement. The first is given as a sample

- 0 A tenant from year to year is one who (a) occupies property under an agreement for a definite period (b) occupies property under an agreement for an indefinite period (c) occupies property without an agreement (h)
- 16 A so called escalator clause in a lease is a clause that (a) prohibits the installation of escalators (b) provides for a gradual decrease in the amount of rent (c) provides for specific increases in rent periodically ()
- 17 It is better for a new business to lease rather than to buy a building because (a) it is difficult to anticipate the needs of the business (b) the price of property may increase (c) the location becomes permanent ()

18. A percentage-income lease provides for (a) a payment of a fixed amount, (b) a payment of a percentage of sales, (c) a payment for all repairs ()
19. Ordinarily the one who pays for minor repairs and fixtures in a building is (a) the new tenant, (b) the old tenant, (c) the landlord ()
20. A lease should contain (a) signatures of both the landlord and the tenant, (b) signature of the tenant, (c) signature of the landlord . . . ()

PRACTICAL PROBLEMS

(Chapter V)

Complete the following problems. If you are doubtful about decisions, reread the chapter. After you have completed the exercises you will find suggested solutions on page 303 of this book. If your answers do not follow the suggested solutions, reread your text, then write your answers again.

- 5A. According to the figures given in Illustration No. 20 (page 81, fruit and vegetable stores located in the central shopping district spend about 28.7 per cent of their sales for rent, whereas similar stores located in other parts of the city spend approximately 6.4 per cent. Using these figures, determine what the monthly sales of such a store should be to justify (a) a monthly rental of \$143.50 for a location in the central shopping district, (b) a monthly rental of \$35 for a location in another part of the city.
- 5B. It is possible to lease a certain building for \$200 a month or to buy it for \$20,000. Considering the following factors, determine whether it is better to lease or to buy and by how much per year. The assessed valuation is \$15,000, and the tax rate is \$25.50 a thousand, insurance for \$16,000 at a rate of 75 cents a hundred must be taken out for three years, the estimate for annual repairs is 1 per cent of the purchase price, the estimated annual depreciation is 2 per cent, interest on the investment is 5 per cent.
- 5C. A percentage-income lease requires a tenant who operates a drugstore to pay an annual rental of 8 per cent on the first \$10,000 of sales, 9 per cent on the next \$10,000 of sales, and 10 per cent on all additional sales. If the sales during a certain year are \$25,500, what should be the amount of the annual rent?

CHAPTER VI

EQUIPMENT PROBLEMS

Purpose of the Chapter. The term *equipment* is a very broad one and includes a large number of items. In this chapter the discussion of equipment will be limited to a few of the more common types in order to illustrate some of the equipment problems that confront a business. The following important problems in connection with equipment will be discussed in this chapter:

1. What are the advantages and the disadvantages of the various kinds of display and storage fixtures?
2. What kinds of equipment should be used for the handling of money and the keeping of records?
3. What particular make of equipment should be purchased?
4. What terms do the sellers of equipment give to a purchaser?

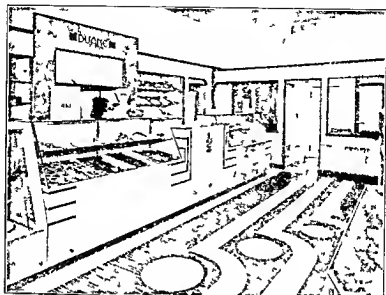
Equipment in Selling Departments. It is important that the fixtures used in a selling department be in keeping with the merchandise being sold. If ultramodern merchandise is being sold, the fixtures should also reflect the ultramodern style. Cheap and old-style fixtures will detract from high-priced merchandise. In men's stores, heavy, rugged furniture and dark-colored fixtures may be used to give an effect of masculinity. In women's stores, there should be light colors and artistic fixtures to create a feminine atmosphere. The fixtures in a rural store should not be too expensive because, if they are, they are likely to give the impression of high overhead expenses.

Display and Storage Fixtures. Formerly merchandise for display and immediate use was stored in the cardboard boxes in which the goods arrived from the manufacturer or the distributor. In retail stores these boxes were placed

under the counter or on shelves back of the counter. This antiquated method is still used in thousands of small stores and even in some large stores but it does not meet adequately the requirements of modern merchandising. Modern merchandising demands display, protection, and speedy service from its fixtures. If cardboard boxes are placed under the counter, they are easily broken by the foot of a salesclerk or the broom of a person sweeping and cleaning. Covers may be torn easily or may not be replaced tightly by the clerk. It is therefore possible for the contents to be soiled by dust and dirt. Constant handling makes the cardboard boxes soiled and unattractive. When a clerk places such boxes on the counter and prepares to show the merchandise stored in them, a customer may be influenced against buying. There are often health ordinances that require the business to keep certain products in closed and sometimes in refrigerated display and storage fixtures. Special fixtures are available for practically every kind of merchandise, whether it be spools of thread or expensive fur coats.

The preceding discussion with regard to the use of shipping cartons does not apply, however, in handling reserve stock. The original shipping cartons are usually quite convenient for storing reserve stock. In fact the merchandise often can be kept better in these cartons than in any other way.

A customer usually enters a store to buy one or two articles, but he may buy others if they are brought to his attention. One of the simplest ways to bring additional merchandise to his attention is to have it displayed attractively in full view. Glass fronts on stock drawers, glass showcases, glass tops on counters and glass doors on wardrobes containing delicate and dainty clothing are means by which goods are given proper display, as well as protection. Food products not only are displayed attractively in glass cases but also may be kept from spoiling by means of refrigerated display cases. Illustration No. 26 shows how baked goods can be displayed attractively through the use of the proper fixtures. Notice how the design in the floor



Armstrong Cork Company

Illustration No 26—Baked Goods Attractively Displayed

is planned to draw the customer to the back part of the room. The ovens are located in the rear of the salesroom.

The use of proper storage and display equipment permits quicker service. Steaks, chops, roasts, and other cuts of meat can be prepared in advance of actual sale and then placed in refrigerated display cases. When a customer wishes a steak or chops it is not necessary for him to wait until the butcher goes into the storage refrigerator, brings out a large portion of meat, places it on the cutting block, sharpens a knife, cuts off a part, and then returns the large portion to the storage refrigerator. Likewise, service to the customer is accelerated when the salesman of men's hats pushes open a glass door on a wall display case of hats and selects one for the customer. Such a procedure is quite in contrast to that of storing hats in cardboard boxes many of which must be opened before the customer gets an idea of what hats are being offered for sale. Illustration No 27 shows both wall display cases and a counter display case for men's clothing.

*General E. L. Company*

Illustration No. 27—Display Cases Protect the Goods and Permit Quicker Service

As a general principle goods should not be displayed above the average eye level. Goods in large display cases on the floor should be arranged so that the customer need not stoop to get a good view of them. If there are shelves in the display case they should be so arranged that the upper shelves do not hide the goods on the lower shelves. Narrower upper shelves may be used. Some of the glass cases in Illustration No. 26 of the Duane Bakery show this feature of display cases.

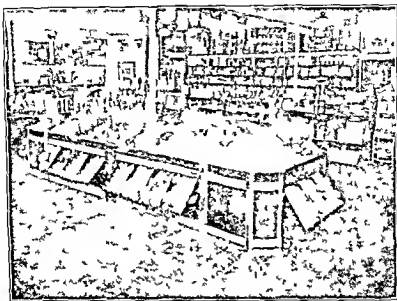
Low Store Fixtures Fixtures including counters, display cases and cabinets should be low enough so that a customer standing in one part of the store may have an unobstructed view of the other parts of the store. This practice is desirable because it brings to the customer's attention merchandise displayed in other departments. The customer may therefore be induced to make further purchases. Fixtures against side walls may be higher as they will not obstruct the view of customers.

Many of the modern fixtures are of metal instead of wood. Such fixtures are lighter in weight than the old-fashioned ones made of wood. Wooden fixtures are liable to develop rough edges which easily damage delicate fabrics.

Open Display Fixtures In some types of businesses the open display fixture is very popular. Tables, racks, and bins that make it possible for the customer not only to see but also to handle and examine the goods are known as *open display fixtures*. Variety stores such as Woolworth's use them almost to the exclusion of other types of fixtures. Hardware stores also make use of this type of fixture. Grocery stores are beginning to put more of their merchandise on open display tables. Roadside stands, fruit and vegetable markets, and gift shops make extensive use of open displays. Making it easy for the customer to come into personal contact with the goods usually results in greater sales than if the goods are hidden away in drawers or on shelves, a back of counters. Unless merchandise is wrapped in cellophane, there is the disadvantage of soilage and damage resulting from the handling and examining of certain types of goods by customers. Illustration No. 28 shows an open display of fresh fruits and vegetables. Notice that the display fixture has devices for emitting a fine spray of water over the vegetables. This moisture keeps the vegetables looking fresh and reduces loss from spoilage.

Many stores make use of *bargain* or *special tables*. A grocer may have a special price on a brand of canned peaches that he is discontinuing, or a clothing store may have a table of second-quality, slightly defective, or soiled men's shirts marked to be sold at bargain prices.

Comfort and Convenience of Customers The modern business depends upon more than quality goods at fair prices to build the goodwill of customers. It strives particularly to make the customer comfortable while shopping. At glove counters in shoe stores, rug departments and millinery stores, comfortable chairs and seats are provided not only for customers but also for friends who might



Dayton Display Fixture Company

*Illustration No 28—A Display Fixture for Keeping
Vegetables Fresh*

be accompanying the customers. In most cases chairs are more desirable than seats or stools fastened to the floor because they can be moved quickly to wherever they are needed. At lunch counters and soda fountains however the stools are usually fastened to the floor. Such stools formerly were quite high and the customer had to climb awkwardly on and off them. Recently counter stools have been made the height of ordinary chairs and the counter has been lowered accordingly for the purpose of making the customer more comfortable. Metal chairs and stools are to be preferred to wooden ones because there is less danger of damage to the hosiery and other clothing of customers. Gasoline filling stations and large stores provide washrooms for the convenience of customers.

Self-service grocery stores provide baskets into which customers may place purchases selected from shelves and tables. The large supermarkets provide deep wire baskets mounted on wheels for the convenience of customers. Some

of these large self-service stores have a continuous track waist high, running around the store in front of the shelving. On this track the customer sets the market basket with four small wheels and pushes it along easily, like a tray on a cafeteria rail, as he selects his purchases.

Lighted Display Fixtures Wall cabinets and counter display cases have their attention value greatly increased when lighted. Where heat from the lighting unit would affect merchandise, such as candy, meats, and dairy products, the lighting equipment may be mounted outside the front of the case, provided the equipment is ventilated to keep customers from touching the hot reflector, may be placed inside the case in a special ventilated built-in compartment or may be suspended above the glass top of the case, over the front edge and high enough above the floor

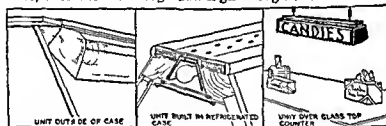


Illustration No. 29—Methods of Lighting Display Cases

so as not to obstruct the view of the customer or of the clerk. Illustration No. 29 shows these three plans of lighting display cases.

The entire face of open stock on shelves can be lighted effectively by placing lighting units in concentrating trough reflectors across the top of the shelves and from eight inches to twelve inches out from the shelving.

Mirrors form an important part of the equipment in such places as millinery stores, dress shops, shoe stores, beauty parlors and men's clothing stores. They should be arranged and lighted so that the customer can get a good view of himself and the article being tried on. Manufacturers can furnish catalogs and information as to the types of mirrors suitable for various purposes.

Interior Signs Lighted signs in the store can be used to call attention to merchandise being featured and also to help the customer find departments easily. These signs may be permanently fixed such as a lighted sign hung from the ceiling or they may be temporarily placed on the wall above merchandise on display. Temporary signs may be cut from cardboard or thin metal and fastened around light globes. Various types of interior signs are shown in Illustration No. 30.

Signs at Store Fronts A suitable electric sign at the store front may be used to attract new customers and to serve as a reminder to present patrons. A vertical projecting sign is usually most effective as it can be seen clearly from both sides. A sign across the face of the store building sometimes may be more in keeping with the general treatment of the store front.

Modern store signs such as neon signs make possible the use of color and varied designs. The design, color or colors and size depend largely upon the signs used on neighboring stores. To stand out such a sign should be different from those used by neighboring stores and should be so placed that it can be seen from many angles by passers by. Bright flashing signs that are liable to be annoying should not be used. Most cities have building codes regulating the size, location, types and fastening of outdoor signs. In such cases a permit must be obtained.

Measuring Equipment To ensure greater accuracy and to give better service to the customer many kinds of measuring equipment are being used by the businessmen of today. Gasoline was formerly pumped by means of a hand pump into one gallon or five gallon containers and then transferred to the fuel tank of the automobile. Modern pumps electrically operated now transfer the gasoline directly to the fuel tank of the automobile. A dial on such a pump indicates to the customer the exact quantity and the total cost even if a fractional part of a gallon is pumped. Another dial shows the total gallons pumped during the day.

There are many types of illuminated signs that may serve to decorate as well as to illuminate the interior of a store. The signs should harmonize with the general decorative plan. The following are a few examples of types of lighted interior signs:

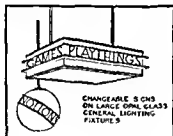
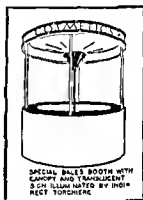


Illustration No 30—Interior Signs

Stores selling yard goods, such as ribbons and dress and drapery materials, have found that, when measuring machines are not used the salesperson has a tendency to give the customer "good measure." Suppose that a salesperson gives an average of three inches 'good measure' on each sale of yard goods and that he makes an average of twenty-four sales daily. The loss from the inaccurate measurement would be computed as follows

24 sales a day

3 inches

72 inches or 2 yards of extra cloth given away each day

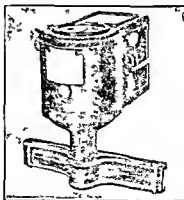
300 working days in a year

600 yards (300×2) given away each year

\$50 average cost of goods per yard (There is of course a great variety of prices for different kinds of yard goods)

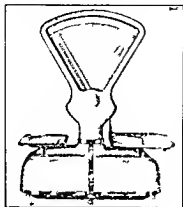
\$300 the loss caused to the management in one year by the inaccurate measurement of one salesperson (600×50)

Careless and dishonest salespersons may, on the other hand, give customers too little by undermeasuring. This practice may cause the store to lose customer goodwill. Modern machines measure yard goods accurately and make a small cut or notch in the material at the point where the clerk should start cutting the goods with a scissors. The machine also may have a mechanical calculator that figures the price automatically and thus eliminates errors that clerks might make in figuring such amounts as $4\frac{3}{8}$ yards at 17 cents a yard. Illustration No 31 shows a cloth-measuring machine.



The Measuregraph Co
Illustration No 31—A Cloth
Measuring Machine

Weighing scales that automatically compute the total cost of the items being weighed are desirable fixtures for businesses that sell bulk products.



Toledo Scale Company

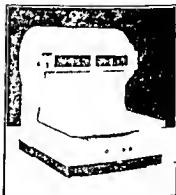
*Illustration No. 32—A Self
Computing Pointer Scale*

A common type of scale is shown in Illustration No. 32. The long, white movable pointer, shown pointing at 0, has on it certain numerals from 10 to 125. These are the prices per pound or other unit. To determine the selling price of a quantity of butter being weighed, the salesperson finds the numeral on the long, white movable pointer that corresponds to the selling price per pound and then determines at what numeral

on the large scale the pointer is resting.

The average net profit of food stores is under 5 per cent. Five per cent of one pound is four fifths of an ounce. If every customer were given one ounce overweight with each pound there would be a resulting loss instead of a 5 per cent profit. In order to prevent profits being given away through errors in reading the scale, certain models contain powerful optical lenses to magnify the figures on the computing chart of the scale. Illustration No. 33 shows such a model.

The four lenses in this type of scale are carried in a sliding frame. By a simple shift of the frame the visible surface of the chart is changed. The result, as shown in Illustration No. 34, is a double price range, one for low prices and one for higher prices. Price ranges can be obtained to fit the particular business. In this illustration



Toledo Scale Company

*Illustration No. 33—A Self
Computing Scale with
Magnifying Lenses*

the price per pound is shown across the bottom of each lens (4 5 6 7 8 9 etc) The reading line shows the weight of the goods in the right hand column of each lens (approximately 6 pounds 4 ounces in this illustration) By following the reading line across the chart to the proper price column the clerk can determine the value of the goods being weighed. For example in this illustration if

LENSES AT LOW PRICE RANGE POSITION



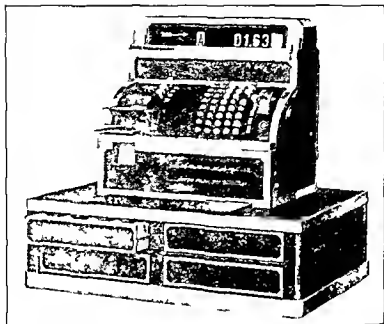
LENSES AT HIGH PRICE RANGE POSITION

*Illustration No 34--Reading a Self Computing Scale*

the value of the goods were 4 cents a pound the reading line would show a total of 25 cents if the value were 20 cents a pound the total would be \$1 25 if the value were 34 cents a pound the total would be \$2 12

Cash Registers Most businesses of today use cash registers entirely or partially in handling cash Such registers have been designed for almost every need that a business may have in handling cash Most cash registers perform the following operations at one time

- 1 Indicate on a large dial the price of the article sold
- 2 Print a receipt to be given to the customer
- 3 Accumulate totals of sales by departments such as meats groceries fruits and vegetables
- 4 Give the totals of sales made by various salespeople
- 5 Give the number of transactions by departments and the number of sales made by each salesperson
- 6 Indicate the total sales
- 7 Provide a place to keep money for making change



Manufactured by the National Cash Register Company

Illustration No 35—A Cash Register for Retail Stores

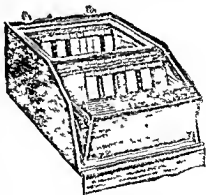
Cash registers make possible speedy service in connection with cash sales. Money can be received from the customer, change made and returned with a receipt, and the customer started on his way in a very short time.

At soda fountains registers that print the amount of the sale on a ticket are often used. The soda clerk gives a ticket to each customer, and the latter then pays his bill at a cashier's desk. This system speeds up service and eliminates the actual handling of money by the soda clerks. It also serves as a check on sales made by the clerks.

Illustration No 35 shows a cash register that is used by retail stores. As there are four individual cash drawers, one may be assigned to each of four salespeople so that responsibility is placed upon each for all the money he handles. This model has transaction counters in the dials just above the money drawers. These counters keep an accurate record of the number of customers' charge sales.

cash sales, amounts received on account transactions amounts paid out, and the number of times "No Sale" was registered in order to open a cash drawer for some purpose other than a sale or receipt or payment of cash. There are also counters to show the number of transactions handled by each of the four clerks. The totals of eight different items, such as cash sales and charge sales, are accumulated inside the register. At the end of the day the register can be unlocked and these totals taken off for the financial records. The machine also provides a printed receipt, a detailed audit strip and a means of imprinting the amount of a charge sale on the charge slip at the same time the amount is recorded in the machine.

Bookkeeping Equipment. In a small business especially a retail store, one of the most important phases of bookkeeping is keeping a record of the amounts due the business as a result of sales to customers on credit. This problem is discussed in more detail in Chapter VIII. In the discussion of the cash register it was emphasized that some cash registers are constructed to record charge sales on slips. Under other systems the charge sales slips are written by hand. Under every system there must be a means of filing these away so that at any particular moment the balance of a customer's account may be determined. Illustration No. 36 shows a type of suitable equipment for this purpose. Copies of sales tickets are filed under the customer's name for quick reference.



*Illustration No. 36—Cabinet for
Filing Sales Slips*

Change-Making Machines. To accelerate the change making process, restaurants, soda fountains and theaters make use of change-making machines. There are two types

of these machines. Let us suppose that a customer made a purchase of 55 cents and handed a one-dollar bill to the cashier. If one type of change-making machine is used, the cashier must determine the amount of change to be given the customer, in this case 45 cents. Then, by depressing a key labeled "45," the cashier causes one quarter and two dimes automatically to drop out of the machine. If the other type of machine is used, the cashier depresses the key that corresponds to the amount of the sale, in this case "55," and causes the correct amount of change to drop out.

Adding and Calculating Machines. Almost every business regardless of its size has a need for an adding or calculating machine of some kind. Adding and calculating machines serve two purposes,

the first to save time and the second to assure accuracy in calculations.

These machines are generally classified as (a) full keyboard adding listing machines, (b) ten key adding listing machines, (c) key-driven calculators, and (d) crank-driven calculators. Each machine has certain specific characteristics and advantages peculiar to its construction.

One class of machine is commonly referred to as the *adding machine*. These machines are used primarily to add and subtract, although they may also be used to multiply and divide. The two machines in this classification are the full keyboard machine and the ten key machine.

The full keyboard adding listing machines include machines sold under the trade names of Burroughs, Allen-Wales, Victor, Monroe, and Corona. These machines have columns running from one to nine in a vertical line with horizontal columns in units of tens, hundreds, thousands,



Illustration No. 37—Full Keyboard Machine

etc. An example of the keyboard of such a machine is shown in Illustration No 37. It is called a listing machine because the figures are listed on a paper tape which may be kept as a permanent record. This tape is also useful to hand to customers when adding up the amount of a sale. The cash register may serve essentially this same purpose. Some small adding listing machines have a cash drawer which makes them essentially a cash register.

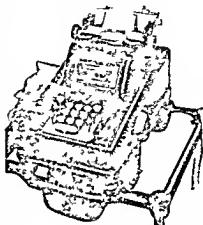


Illustration No 38—Ten Key Machine

The keyboard of a ten key adding listing machine is shown in Illustration No 38. This machine has keys numbering from one to nine with another key for the cipher or 0. This machine also lists the figures on a paper tape and may therefore serve essentially the same functions as the full keyboard machine. It is characterized by the Underwood Sundstrand, Remington Dalton, Monarch and Barrett machines.

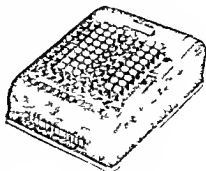


Illustration No 39—Key Driven Calculator

There are two types of calculators. These do not list the individual items on a tape but they record the final results or footings on dials located at the top or bottom of the machine. They may be used to add, subtract, multiply, or divide. Generally speaking, they are faster than the listing machines which makes them valuable for verifying or checking work.

The key-driven calculator obtains its name from the fact that it is operated by depressing the keys. The two machines in this classification are the Comptometer and Burroughs. These machines are used for all fundamental arithmetical computations. One is shown in Illustration No. 39.

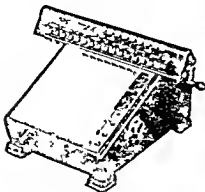


Illustration No. 40—Crank-Driven Calculator

The crank-driven calculator machine which is either hand or electrically operated also performs all arithmetical calculations. It is operated by depressing the keys and turning a crank. Machines in this classification are the Monroe, Marchant, Friden, and Forsden. An example is shown in Illustration No. 40.

In buying one of these machines, it must first be determined whether you want the slower listing type of machine providing a permanent record or the faster nonlisting type of machine used principally for verification of figures.

Determining the Kind of Equipment. When a businessman has decided that it is desirable to purchase equipment for a certain purpose, he must next determine the exact make of equipment needed. By consulting trade papers, directories and other businesses using similar equipment, one can obtain the names of equipment manufacturers. From these manufacturers one should obtain literature descriptive of the equipment that will probably best fit the needs of the business. The next step should be to interview representatives of the equipment manufacturers and let them offer suggestions with regard to the most suitable kind of equipment. Most manufacturers will give demonstrations and furnish technical data on the operation of machines. Some of them will leave equipment on trial so that a thorough test may be made. Often it is possible to observe the equip-

ment in use in other plants. Comparisons as to the original cost, the probable life, the rate of depreciation and the repairs or services required should be made.

Standardization of Equipment So far as possible it is desirable that a particular type of equipment be selected as a standard for use in all similar work. If display cases are of the same size and make it is easy to shift a display case from one part of the store to another during special sales or busy seasons without breaking up the harmony of the entire store display. Furthermore a neat appearance is given to the store if all the equipment is alike. If all the cash registers in a store were manufactured by the same company, it is easy to obtain service on them and for employees to shift from one machine to another. Likewise if all the typewriters in an office are of one make the service problem is simple and employees can use any machine.

Another advantage of standardization is that one can usually purchase a large number of the same articles at a lower price per article than if a small number is purchased. If equipment is purchased in large quantities better repair and maintenance service is ordinarily available. For example, there are four typewriters in an office each of which was made by a different typewriter manufacturer. Two of them need repairs. It is necessary that two service men each from a different company, make a trip to take care of the repairs. If all four of the typewriters were of the same make, one service man could make the trip to take care of all the repairs.

Less variety in supplies, which means less cost per unit is necessary when equipment is standardized. When all the typewriters in an office, for instance are of the same make only one kind of typewriter ribbon need be carried in stock. If various kinds of display cases are used in a store it may be necessary to stock a variety of electric light bulbs for the proper illumination of each kind.

Determining Whether to Purchase Equipment Business men have often purchased equipment because it seemed to

be desirable but they did not stop to consider whether such a purchase would be advantageous from a financial viewpoint. Before buying equipment one should consider the following factors

Depreciation

Repairs

Increased operating costs such as electricity and insurance

Rental charge for space occupied

Interest on capital invested

All the possible costs resulting from the purchase and the maintenance of the equipment should be added and then compared with the probable financial income resulting from the use of the equipment. Then one is more likely to purchase equipment only when it is definitely advantageous to do so. Sometimes it is not economical to continue to use old equipment but in other cases it is economical to purchase new equipment to replace the old.

A certain public utility (gas and electricity) company found it necessary to have photostatic copies made of some 10 000 sheets of handwritten typed and printed records. The cost of having the work done by a commercial photocopy company would have been \$5 000. After investigating the cost of buying equipment to do the work the company determined the following facts

Cost of Equipment		
Photostat	\$1 200	
Dryer	180	
Lamps	160	
Washer	25	
Trimming board	25	
Total		\$1 600
Cost of Materials		
Paper chemicals used in the developer and in the fixing bath etc.		350
Labor (two months)		300
Rental value of space occupied by the equipment (\$15 a month) including heat and light costs		30
Interest on equipment cost (2 months at 6 per cent)		16
Depreciation (1 per cent a month)		32
Total cost		\$2,328

As a result of these figures the company decided it would be advantageous to purchase the equipment and materials and to do its own photostatic work.

Leasing Equipment. Some equipment manufacturers do not offer certain of their products for sale. Instead they lease such equipment to users believing that better service will be given under such conditions. The equipment leased is usually of the type that needs frequent servicing. The maker of the equipment maintains a corps of service mechanics to keep the equipment in proper order. For example the United Shoe Repairing Machine Company leases to shoe repair shops a cement press for an initial rental fee of \$35 and a monthly rental of \$1. It leases a stitching machine on a different basis. The initial license fee is \$450 on a new machine or \$200 on a rebuilt machine. In addition, it gets a royalty of 12 cents a thousand stitches, with a guarantee of \$5 a month. If these machines need servicing however, the shoe repair shops need not pay for the repairs. All that the manager of such a shop has to do is to notify the local service office.

Some examples of other equipment that is leased are

Electric bookkeeping and accounting machines

Proof machines for banks

Postage meter machines

Registers used in streetcars, busses, and the like

Rental for Short Terms. Frequently a business may wish to rent equipment for a short period of time. For instance, a company may rent long-carriage typewriters for the making of annual reports. During certain peak seasons a business may find it desirable to rent additional typewriters, Addressograph equipment, or calculating machines. The rental charges paid by the lessee may often be applied toward the purchase of the machine should the lessee decide to buy it. A clause governing such a situation is contained in the rental order in Illustration No. 41.

Terms of Purchase. The terms given to purchasers of equipment vary with the different kinds of equipment. In most cases a substantial down payment ($\frac{1}{4}$ to $\frac{1}{3}$) is re-

ment on the deferred-payment plan. It includes an allowance for a used piece of equipment being traded in. Read carefully the purchaser's obligation, which is printed in small type.

There are many forms of contracts under which equipment may be purchased. In some cases the contract may be a conditional sales contract, but in others it may be a chattel mortgage contract. These are explained in Chapter XII. In the case of the conditional sales contract, the equipment does not become the permanent possession of the purchaser until it has been paid for. In the case of the chattel mortgage contract, it becomes the property of the purchaser at the time it is delivered, but the seller holds a mortgage claim against it until the amount specified in the contract is paid. Occasionally, for a small unpaid balance, the seller does not require any special contract. The buyer is merely billed on open account.

SELF-CHECKING STUDY QUESTIONS

(Chapter VI)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer, reread the chapter until you find the correct answer, then compare your answers with those on page 300 of this book. Refer to the printed answers only after you have made a serious effort to answer all questions, for otherwise the questions will not be of greatest value to you. If you have any incorrect answers, reread the part of the chapter in which those questions are discussed.

True-False Questions

Directions After each statement below that is true, draw a line under "true." After each statement that is false, draw a line under "false." The first statement is given as a sample.

0. Cheap, old-style fixtures detract from high-priced merchandise. true false
1. If one is catering to a low-income group with low-priced merchandise, it is generally considered that fixtures and equipment should not be elaborate. true false
-

- 2 Lighted display signs are suitable only for out side use true false
- 3 Counter displays should not obstruct the view of the shelves true false
- 4 One may have to obtain a permit to construct an outside sign true false
- 5 The function of a cash register is to provide a safe place for the keeping of money true false
- 6 A change making machine is recommended for speed in making change true false
- 7 A key driven calculator uses a paper tape for recording the figures true false
- 8 An adding machine can also be used to multiply true false
- 9 Some equipment may be rented but not purchased true false
- 10 When equipment is purchased on an installment plan with a conditional sales contract it becomes the property of the buyer when the contract is signed true false

Multiple-Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement The first is given as a sample

- 0 Equipment that is commonly leased or rented is (a) a postage meter machine (b) chairs (c) shelves (a)
- 11 Furniture for a men s furnishings store should be (a) rugged (b) dainty (c) light in color ()
- 12 The calculating machine operated by depressing keys and turning a crank is (a) the Dalton (b) the Allen Wales (c) the Marchant ()
- 13 The advantage of an open display is that it (a) protects merchandise (b) enables the customer to examine the goods (c) conserves space ()
- 14 The main advantage of a calculating machine over an adding listing machine is (a) speed (b) accuracy (c) printed record ()
- 15 In planning the selection of equipment for a special type of business one can get information in regard to suitable equipment through (a) newspaper advertisements (b) trade journals (c) textbooks ()

PRACTICAL PROBLEMS

(Chapter VI)

Complete the following problems. If you are doubtful about decisions, reread the chapter. After you have completed the exercises you will find suggested solutions on pages 303 and 304 of this book. If your answers do not follow the suggested solutions, restudy your text, then write your answers again.

- 6A. In weighing butter by the bulk, a retail salesperson gives an extra ounce to each customer buying a pound. (a) If there is a daily average of 50 customers during a year of 304 working days, how many pounds of butter are given away during the year? (b) If the retailer pays an average of 24 cents a pound for the butter and sells it at an average of 32 cents a pound, what are the wholesale value and the retail value of the butter given away?
- 6B. A certain model of the Addressograph sells for \$385 on terms of net 30 days. If the deferred-payment plan is desired, the customer may make 12 monthly payments but must pay a finance charge of 4 per cent on the balance remaining after the down payment. If a customer makes a down payment of \$80, what will be the amount of each of the 12 monthly payments?
- 6C. A shoe repair shop leases a cement press and one rebuilt stitching machine. Using the figures given on page 117 for the United Shoe Repairing Machine Company, determine the total rental cost for the first year of operation. The stitching machine does the following amount of stitching:

January	35,000	May	70,000	September	75,000
February	60,000	June	63,000	October	70,000
March	65,000	July	55,000	November	62,000
April	60,000	August	50,000	December	53,000

CORRESPONDENCE AND DISCUSSION PROBLEMS

(Chapters IV, V, and VI)

If you are a regularly enrolled student in the United States Armed Forces Institute, you are entitled to assistance from an instructor by correspondence if you wish such assistance. These problems are for that purpose. However, you are not obligated to send in these assignments. If you want suggestions on your work, write out your answers to these assignments and send them to the United States Armed Forces Institute as instructed on page v of this book.

If you are working in a class under an instructor, the assignments may be used for discussion or for written outside work.

1. Why are stores usually found in groups commonly known as shopping centers?
2. Why are rents in a downtown district higher than those in an outlying district?
3. Name several common errors made in selecting locations for retail stores.
4. What factors do you think would help to determine a good location for a filling station?
5. Why is it usually more desirable for a new business to lease rather than to buy housing facilities?
6. Why is it desirable to have a written lease?
7. Why is a short-term lease preferable for a new business?
8. What are some factors to be considered in buying housing facilities for a business?
9. Explain the principal functions performed by a cash register.
10. Give some of the probable advantages resulting from the standardization of equipment.
11. How can a businessman determine whether it is advantageous from a financial viewpoint to purchase equipment?

MID-COURSE REVIEW

This test provides in brief form an opportunity for you to test and recheck yourself on the first half of this course before proceeding with the remaining part of the course. It is not an attempt to test you exhaustively on all of the topics that you have studied, but it provides a representative sampling of questions on some of the more important topics that you should remember. Answers will be found on page 309 of this book. The questions have been grouped so that you can restudy the chapters that contain answers you missed. Since this review is only a sample, you should study carefully the entire chapter in which you make two or more errors. When you have satisfied yourself as to your understanding, proceed with the course.

Multiple-Choice Questions

Directions: Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement. The first is given as a sample.

- 0 The owner of an individual proprietorship owns all his assets provided there are no (a) creditors, (b) partners, (c) bonds owned (a)

(Chapter I)

1. Studies show that the percentage of retailers in business at a particular time who will fail the following year is (a) 2 per cent, (b) 5 per cent, (c) 15 per cent. ()
2. As a cause of business failure "insufficient capital" ranks (a) below "bad debt losses," (b) below "competition," (c) above "poor location" ()
3. In any community the type of store required in greatest number is (a) drugstore, (b) grocery store, (c) dry cleaner ()
4. A business is most likely to succeed if it (a) copies competitors' ideas, (b) solves or simplifies an ordinary problem, (c) manufactures or sells a novel new invention ()
5. A period of recovery is the best time to start a new business because (a) buying begins to increase, (b) prices begin to decline, (c) interest rates are low ()

(Chapter II)

6. The approximate turnover of merchandise in a furniture store is (a) 10 to 12, (b) 2 to 4, (c) 6 to 8 ()

- 7 If a business has a turnover of 3 it means that the merchandise is on the shelves from the time it is bought until it is sold for an average of (a) three months (b) six months (c) four months ()
- 8 Money can be borrowed from an insurance company by (a) pledging real estate (b) pledging goodwill (c) pledging merchandise ()
- 9 Cash that is available for current expenses is called (a) capital stock (b) fixed assets (c) working capital ()
- 10 The least amount of capital is required when (a) turnover is low (b) turnover is high (c) sales are made on credit ()

(Chapter III)

- 11 A sole proprietorship is (a) a business owned by one individual (b) a limited partnership (c) a private corporation ()
- 12 The operating agreement of partners is called (a) a financial statement (b) articles of copartnership (c) a contract of partnership ()
- 13 In a partnership each partner is responsible for the following act of other partners (a) contract to buy merchandise for the business (b) personal assault (c) damage caused by partner's car being operated for personal use ()
- 14 A registered bond obtains its name from the fact that (a) it is registered in the state capitol (b) it is registered for Federal tax purposes (c) it is registered in the name of the owner on the books of a corporation ()
- 15 If there are any profits the ones who must be paid first are (a) bondholders (b) preferred stock holders (c) common stock holders ()

(Chapter IV)

- 16 One side of a street may be a better location than the other side because (a) the rent is higher (b) the rent is lower (c) customers prefer it because it is shady ()
- 17 A store in the lowest rent district (a) can sell at the lowest prices (b) does not necessarily have an advantage (c) has to charge the highest prices ()
- 18 It is usually best to pick a location for a shoe store (a) in a community shopping center (b) in a low rent district at the edge of town (c) in the best building ()

(Chapter IV)

- 46 A good location for a novelty 5 and 10 cent store is in the center of a shopping district true false
- 47 Transportation facilities are often an important factor in determining a business location true false
- 48 A business which pays the lowest rent can usually sell at the lowest prices true false
- 49 In a large city it would be better to locate a drug store away from competition in an area devoted exclusively to automobile salesrooms than it would be to locate in a community shopping center true false
- 50 A residential section is a good location for a gasoline filling station true false

(Chapter V)

- 51 A good policy is to obtain a lease for a short period but renewable for a longer period true false
- 52 The landlord usually pays the taxes on a building true false
- 53 Ordinarily the tenant must pay for fixtures that are installed true false
- 54 The escalator clause in a lease provides for an increase in the amount of rent true false
- 55 The amount of rent paid is sometimes based on a percentage of net sales true false

(Chapter VI)

- 56 An adding listing machine is useful in a business because the figures are printed on a tape true false
- 57 Counter displays should be confined to those not over two feet high true false
- 58 Closed displays are desirable for all types of merchandise true false
- 59 The key-driven calculator may be used to multiply or divide true false
- 60 The advantage of the closed display is to protect goods from sunlight true false

BUSINESS RISKS AND INSURANCE

Purpose of the Chapter. Every business is confronted with certain types of risks. Some of these can be overcome by good business management. Others must be overcome by various forms of insurance. The purpose of this chapter is to explain the various risks and to show how a business man may obtain protection from them. The following are some of the questions that will be answered.

- 1 What are the different types of business and economic risks?
- 2 How can a businessman overcome some of these risks by good management?
- 3 How does insurance protect a businessman from risks?
- 4 What types of insurance are available to the businessman?
- 5 What function does life insurance serve in business?

General Types of Risks. Risks are of many varieties. They are sometimes classified as natural, personal, and social risks. They may be classified in general as follows: floods, storms, fires, robbery, strikes, riots, forgery, racketeering, panics, price fluctuations, taxes, tariffs, laws, changes in demand, and economic changes.

Special Types of Risks. The businessman is particularly concerned with certain special types of risks. For instance, anyone who has operated a business has discovered that people change in their needs, desires, and wants. These changes cause serious business risks. Most products are produced in anticipation of sale. If the needs, desires, and wants of consumers change, however, those who have produced goods are liable to suffer a loss.

Fashions, particularly in women's clothing, change frequently. Manufacturers and merchants of such clothing are sometimes stocked heavily at a time when styles change.

or when buyers fail to accept new styles. Whoever is stocked with the merchandise therefore suffers a loss and probably has to sell the goods at a special sale. A wise merchant will watch his purchases carefully to be sure that he does not overstock. He will see that slow moving style merchandise is disposed of through some special sale.

Methods of heating, transportation, and lighting cause serious business risks. For instance, the owner of a store that was thoroughly modern a few years ago may find all his customers going to another store that has recently had air conditioning equipment installed. New decorations and new lighting equipment may attract customers away from an old established store. Improved methods of transportation may give one type of business an advantage over another. For instance, busses may eliminate the need for streetcars, or private passenger automobiles may injure the business of bus companies. There are numerous such changes going on regularly. Probably the most recent significant change has been the introduction of the radio, which at least temporarily caused piano and phonograph manufacturers to lose sales. It is possible that in the future the development of television may cause a serious business risk to manufacturers of ordinary radios and in turn may cause motion picture producers and theaters to suffer a loss.

The changes in the weather are sometimes serious business risks. For instance, a delayed summer season may prevent manufacturers and stores from disposing of summer clothing. A cool summer may injure the business of pleasure resorts because people may stay comfortably at home.

The fluctuation in business conditions is another serious risk. It can be overcome to some extent by studying business conditions and by planning carefully in anticipation of changes in business. Therefore, a knowledge of economics is valuable to a businessman.

Within any business community there are numerous local risks, such as the relocation of highways, which may cause customers to change their sources of supply to more con-

Economic Cycle. There is probably no risk in business that is so hazardous as the change in business conditions. For instance, when business conditions are at their best and there is a period of so-called prosperity, numerous new businesses are started, but many of these do not become well established before a period of decline begins. The period of decline may therefore force a large number of them to go out of business. A more detailed discussion of the business cycle, or economic cycle, was given in Chapter I.

Insurable Risks. Some of the previous risks are hard to predict and hard to control. A businessman can avoid some of those risks by good business management. However, there are many risks for which protection can be obtained through various types of insurance. These include the following:

Fire	Embezzlement by employees
Theft	Injury to customers
Windstorm	Loss of shipments
Auto damage	Disruption of business due to fire
Death	Injury to employees

A small business cannot afford to take serious risks when it is possible to obtain protection through some kind of insurance. A large business may sometimes take risks which would be too great for a small business. For instance, a large corporation operating a fleet of 500 automobiles finds from its experience that not more than an average of one car is stolen in a year. It is not only cheaper for it to stand the loss on stolen cars than to insure them, but also the loss of even two or three cars in a year would not be serious. However, if a small business owns one automobile and that one car is stolen, the loss would be serious.

In the following discussion the different kinds of insurance companies are described and the features of various kinds of insurance policies are explained. Study these in terms of how they can help you.

Types of Insurance Companies. Insurance companies collect from policyholders amounts that are called *premiums*. A premium is a payment for protection against some risk, such as fire, sickness, accident, or death. Pre-

miums are paid weekly monthly quarterly semiannually or yearly the time of payment depending upon the nature of the insurance the type of policy and the kind of insurance company The funds collected from policyholders are used by the company in somewhat the same manner as cash deposits are used by banks In other words with the funds paid by policyholders insurance companies make investments that earn an income An insurance company must of course keep a reasonable amount of cash available to pay the claims of policyholders in case of fire accident death ill health or other similar happenings The way that an insurance company handles its affairs is governed by law

There are two general types of insurance companies One is known as the *stock company* and the other as the *mutual company* The stock company is a corporation that is formed according to the laws of the particular state The stockholders own the company and operate it although they are not necessarily policyholders An insurance company of this type obtains money from the sale of stock to stockholders as well as from the collection of premiums from policyholders The profits of the company are paid to the stockholders who are the owners of the business In some companies the policyholders also share in the earnings after the stockholders have been paid a stipulated amount

A mutual company must also be organized under the laws of the particular state The policyholders in such a company are however the owners Each person or business that is insured in a mutual company becomes a member of the company and is entitled to a share in the ownership the control and the earnings The ownership of the members is not evidenced however by shares of stock as it is in a stock company

Although the policyholders do not own shares of stock they are in a sense partners or members of a co operative organization The only way in which they can exercise their power of control or management is for a sufficient number of them to register a protest or to act as a group in demanding changes in the management or the operation

of the business. Of course, the insurance departments of the various states look after the interests of policyholders and therefore scrutinize the management of these companies.

Policyholders in mutual companies usually pay premiums at a predetermined fixed rate, comparable to the rate established by stock companies. The policyholders in mutual companies, however, may receive dividends or have to pay assessments. If the company makes a profit, each policyholder shares in proportion to the amount of his policy. If the company fails to make a profit, each policyholder (except those in most life insurance companies) is assessed a certain amount so that the income of the company will be equal to its expenditures. Usually the maximum amount of an assessment cannot exceed the original premium.

It is to the advantage of a mutual company to select carefully those risks on which insurance is to be issued. The company can thereby establish a low percentage of loss. If the percentage of loss is low, the net rates are correspondingly low. For instance, if the buildings insured by a mutual company are seldom damaged or destroyed by fires, the net rates of that company are very low. If there are many fires, however, the rates are high. It is furthermore of particular advantage to a mutual company to increase fire prevention activities and thereby to reduce the number of fires. Some mutual companies are not particularly careful in selecting risks. Others do, however, select only high grade risks while some confine their insurance to restricted localities, to particular types of industries, or to selected groups of individuals. If a businessman is going to insure in a mutual company, he should be sure that the company selects its risks carefully.

How Insurance Rates Are Established. Insurance rates vary according to the risk that is involved. For instance, if there is a large number of robberies in a particular community, theft insurance is high in that community. If fire protection is bad, buildings are not fireproof, and fires are frequent in a certain community, the fire insurance

rates are high in that community. Rates charged for insurance are based upon the past experience of the insurance company in distributing losses over all the property that is insured. The rates established for any particular year are therefore in anticipation that the losses for that year will be essentially the same as those of the previous year. Naturally, when risks are reduced rates can be reduced.

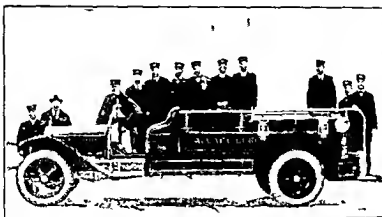
An insurance company must not only pay the claims of its policyholders who have suffered losses but must also obtain enough to cover all expenses and particularly if the company is a stock company to ensure a profit as well. Sometimes the carefully selected risks of a mutual company result in such low costs of operation that those insured in the company have returned to them some of the profits. Some stock companies also follow the practice of returning to their policyholders a certain amount of the profits.

The following factors for instance are taken into consideration by an insurance company in establishing fire insurance rates on property:

- | | |
|---------------------|--|
| 1 Water supply | 7 Structural conditions |
| 2 Fire department | 8 Climatic conditions |
| 3 Fire-alarm system | 9 Correlation between
the water supply and
the fire department |
| 4 Police system | |
| 5 Building laws | 10 Fire-sprinkler system |
| 6 Hazards | |

For example, two businesses occupy buildings side by side, in which all the conditions are equal. If one of these businesses installs a sprinkler system it will thereafter pay a lower insurance rate than the one without such a system. In the case of fire insurance the businessman will find it advantageous to consider the various factors affecting the rates. He may save considerable money by installing a fire-sprinkler system or a fire-alarm system. In considering two pieces of property for rental a businessman may wish to select the one on which the insurance rate is the lower.

Fire Insurance. Fire insurance provides funds to replace buildings, furniture and equipment machinery, raw ma



*Illustration No 43—A Salvage Corps Reduces
Fire Losses*

Cincinnati Salvage Corp

terials and finished goods that have been destroyed by fire. Insurance on a building usually does not cover equipment, machinery, and stock. Ordinarily separate policies are required to give full protection from fire loss. The owner of a building should be interested in insurance to protect his investment. The occupant of a rented building should be interested in insurance to protect his business. In buying insurance one should know just what is covered by the policy.

The actual loss in property destroyed by fire is not the only loss to a business. The interruption to business until a new place can be obtained and operations can be resumed will result in a loss of profits and considerable incidental expense. Special types of insurance can be obtained to cover such losses caused by the inconvenience of a fire.

Features of Fire Insurance When a businessman is buying fire insurance, he should know what he is buying and how he will be protected. He should give careful consideration to the amount of his protection, the kind of protection, and special clauses in the policy. Illustration No. 44 shows a typical fire insurance policy.

No businessman has any advantage in being overinsured. As a matter of fact, he will save money by keeping his insurance down to an amount that actually equals the value of the property. Policies when renewed should therefore be revised in amount so that they cover the real value of whatever is being insured. It is therefore important to check the policies carefully before they are renewed.

In most states the actual amount of the loss is paid rather than the insured value. In some states there are so-called valued policy laws. These laws require the face value of the contract to be paid in the event of a total loss regardless of the value of the property at the time of the loss. In the case of items such as manuscripts, rare books, rare pieces of art and other similar articles the value must be determined and agreed upon between the insurance company and the policyholder at the time the policy is purchased.

An ordinary insurance policy provides that the insurance company must repair or replace the damaged property within a reasonable time but it does not cover any loss due to interruption to business. Business interruption insurance is presented later in this chapter.

Instead of paying only for the damage to a replaceable article the insurance company may exercise the right given in the policy to take all or part of the insured article at an appraised value. In such a case the company may repair, rebuild or replace the damaged property with other property of like kind and quality within a reasonable time. In the case of a building that is insured the insurance company may likewise repair, rebuild or replace the damaged property. Insurance companies ordinarily do not exercise this option but usually follow the practice of compensating for the damage and letting the policyholder take care of the property.

The policyholder is required according to the contract to be responsible for the property that has been damaged. In other words he may not abandon it to the insurance company for it still remains his property until an adjustment has been made. The policyholder cannot assume that

immediately after the fire the insurance company is responsible for the damaged property

In every fire insurance policy the property that is covered should be clearly identified as to description and location. The property included in the policy and the property excluded should be definitely understood. In the event of a fire property may be moved to another location for protection. In this location it is covered by the insurance for a certain amount of time usually about five days.



R

Illustration No. 45—Records Should Be Safe from Fire

The standard insurance policy usually excepts or omits such items as accounts, bills, money, notes, and other evidences of debt, deeds, and securities. This fact emphasizes the necessity for keeping such items safely. It is difficult to establish a value for most of them, and as they are not covered by an ordinary policy, extreme care should be exercised in protecting them. Even if such items are insured, the difficulty of replacing them still remains the prime consideration in their protection.

among 50,000 buildings there will be an estimated 1,000 fires during any particular year. The table in Illustration No. 46 shows the ratio of the loss to the entire value of each piece of property.

RATIO OF LOSS TO VALUE	NUMBER
Between 0% and 10%	751
Between 10% and 20%	107
Between 20% and 30%	47
Between 30% and 40%	30
Between 40% and 50%	20
Between 50% and 60%	16
Between 60% and 70%	12
Between 70% and 80%	9
Between 80% and 90%	5
Between 90% and 100%	3
Total number of fires	1 000

Illustration No. 46—Average Percentage of Loss for Each 1,000 Fires

It is evident that most of the losses from fires are small losses. For instance, in 751 cases out of 1,000, the loss from fire will amount to 10 per cent or less of the total value of the property. If one buys regular insurance, he will pay the same rate per thousand dollars of insurance, regardless of whether he has complete coverage or only partial coverage. It is obvious, therefore, that under ordinary insurance, the person who carries complete coverage is penalized by paying a high rate. For example, if a person buys a straight insurance policy covering 100 per cent of the value of his property, he pays the same rate per thousand as a person who carries only a small amount of insurance. There is very little likelihood, however, that the former will ever have a total loss. In other words, straight insurance does not give any inducement to carry a large amount of insurance.

Under coinsurance, however, the insurance company says, in effect, "If you take out more insurance, we'll charge a decreasing rate as you go up the scale in the amount of insurance that you carry." Under coinsurance the amount of insurance carried is stated in terms of a percentage of

the total value of the property. The percentage carried will depend largely upon the custom in the community and the nature of the property being insured. Usually this percentage is approximately the percentage of total destructible loss that is possible. For instance if it can be assumed that only 80 per cent of the property is destructible by fire (a certain proportion of the masonry and concrete work being indestructible) the policy should carry an 80 per cent coinsurance clause and thereby provide insurance covering 80 per cent of the value of the property. The rate is calculated on this basis. The premium rate on buildings is on the average reduced 10 or 15 per cent by coinsurance. If the insured person however is not willing to carry insurance up to 80 per cent of the value of the property he may carry whatever amount he wishes but will have to assume part of the risk. The insured person may carry insurance equal to the total estimated loss or may carry less. The following are examples of how 80 per cent coinsurance clauses operate.

EXAMPLE A

When insurance exceeding 80% of the value is carried.

Value of property	\$10 000
Insurance required	8 000
Insurance carried (face of policy)	9 000

All losses up to \$9 000 are paid in full.

EXAMPLE B

When insurance equal to 80% of the value is carried.

Value of property	\$10 000
Insurance required	8 000
Insurance carried (face of policy)	8 000

For losses of \$5 000 or more the face of the policy (\$8 000) is paid.

All losses under \$8 000 are paid in full.

EXAMPLE C

When insurance of less than 80% of the value is carried.

Value of property	\$10 000
Insurance required	8 000
Insurance carried (face of policy)	5 000

For losses of \$5 000 or more the face of the policy (\$5 000) is paid.

All losses under \$5 000 are paid in the proportion that \$5 000 bears to \$8 000 which is $\frac{5}{8}$.

All these examples of coinsurance can be summarized in one formula

$$\frac{\text{Amount carried (face)}}{\text{Amount required}} \times \text{Loss} = \text{Amount recoverable from the insurance company which however must never exceed the face of the policy}$$

Illustration No 47 is a table showing in detail how various 80 per cent clauses operate. Other clauses operate in a similar manner

Value of Property	Percentage Required by Policy	Amount Required by Policy	Actual Percentage Carried	Amount Carried	Loss	Amount Paid by Insurance Company	Loss borne by Insured
\$10 000	80%	\$8 000	80%	\$8 000	\$9 000	\$8 000	\$1 000
10 000	80%	8 000	80%	8 000	8 000	8 000	0
10 000	80%	8 000	80%	8 000	6 000	5 000	0
10 000	80%	8 000	60%	6 000	6 000	4 500	1 500
10 000	80%	8 000	60%	6 000	8 000	6 000	2 000
10 000	80%	8 000	90%	9 000	9 000	9 000	0

Illustration No 47—How Coinsurance Clauses Operate

The coinsurance clause is usually attached to an ordinary fire insurance policy, as in Illustration No 48

Coverage for Bad Risks. In many communities it is impossible for any particular business to obtain all the insurance it desires through one insurance company. Insurance

COINSURANCE CLAUSE			
In consideration of the sum paid for term under which this policy is written it is expressly stipulated and made a condition of this contract that the insured shall at all times maintain contributing insurance on each item of property insured by this policy to the extent of at least <u>80</u> % of the actual cash value at the time of the loss, and that failing to do so, the insured shall be the extent of such deficit from this, but no more than proportion of any loss.			
If this policy be divided into two or more terms, the foregoing conditions shall apply to each term separately.			
This clause of the report of the insured is attached to and forms a part of Policy No. <u>36520</u> of the			
Fire and Marine		Insurance Company of <u>Minneapolis, Minn</u>	
issued in <u>SHREVEPORT, KY</u> Agency		Dated <u>June 27,</u> <u>1929</u>	
		<u>L. P. Johnson</u> Insured.	
		C/A <u>RA. DOLPH & CO</u> Agent.	
		<u>SHREVEPORT, KY</u>	
NOTICE.—This clause, when attached to policies covering so much as is set on entry, must be signed by the insured, and in duplicate, one copy to be attached to policy the other to daily report sent the Company. Agent must sign in all cases.			

Illustration No 48—A Coinsurance Clause

companies follow a policy particularly in certain high risk districts of insuring only a certain percentage of the value of property. There are two ways however in which a businessman may obtain complete coverage. One is by obtaining two or more policies that together cover the entire value of the property. The other is by purchasing complete coverage from one insurance company which in turn will reinsure part of the value of the property with one or more other insurance companies. When any particular insurance company issues a large insurance policy it usually sells or reinsures part of the risk with other companies. This practice is considered good management on the part of the insurance company because it distributes the risk among a number of companies. Any particular large loss might seriously embarrass a single company but when it is distributed over several companies it is not so significant. In other words several insurance companies bear the loss instead of one company.

Features of Use and Occupancy Insurance Use and occupancy insurance is sometimes referred to as *business interruption insurance*. For instance after a fire in an office a factory or a store the business suffers an additional loss because it cannot carry on its operations in the normal manner. Some of its expenses continue in spite of the fire. These are such expenses as interest on notes, taxes, rent, royalties, certain insurance, advertising, telephone service and certain salaries. The business may lose not only the normal income from sales but also its customers who may go to other sources and never come back. On the other hand during the period when the business may be shut down because of the fire it may save the salaries of certain employees and a few other miscellaneous expenses. The purpose of use and occupancy insurance is to protect the businessman from loss during the interruption and to enable him to get back into normal operation as soon as possible. Several different plans of insurance are provided to cover the losses resulting from business interruption. These are as follows:

- Plan 1 Concerns having reasonably even daily earnings may carry insurance providing for a daily payment not exceeding $1/300$ (or $1/365$ if the business is operated on Sundays) of the face of the policy. This clause may be written to cover two years.
- Plan 2 Businesses in which the daily earnings are not even may take out insurance providing for weekly payments amounting to $1/52$ of the *amount of insurance carried*.
- Plan 3 Businesses in which the earnings are not even from day to day, week to week, or month to month may obtain insurance that provides protection when it is needed but withdraws it when it is not needed. A canning factory that operates during the berry canning season in the spring and the vegetable-canning season in the early fall is an example of such a business.
- Plan 4 In addition to the choices indicated above, coin-surance clauses may be inserted in these policies. The policyholder may consequently be required to carry insurance equal to 80 per cent, 90 per cent, or 100 per cent of the actual use value of the business. These clauses operate for use and occupancy insurance in essentially the same manner as they do for fire insurance policies.

Let us assume that the use and occupancy insurance carried by a particular business amounts to \$300,000 and that the business is not operated on Sundays and holidays. Under the first plan the payments would not exceed $1/300$ of \$300,000 or \$1,000 a day.

Plans 1 and 2 are basic. Plan 3 can be used with Plan 1. For instance, assume that the greatest risk occurs between July 1 and January 1. The payments might be

	PER DAY	NO OF DAYS	INSURANCE
January 1 to July 1	\$ 500	× 150	\$ 75,000
July 1 to January 1	1,500	× 150	225,000
Total		200	\$300,000

Plan 2 is a basic weekly plan. Under it the weekly payments would not exceed $1/52$ of \$300 000, or \$5 769.23 a week. If the fluctuating form in Plan 3 is used with Plan 2 the payments could be arranged as follows:

	PER WEEK	NO OF WEEKS	INSURANCE
November 15 to June 6	\$ 6 000 00	× 29	\$174 000
June 6 to August 1	10 000 00	× 8	80 000
August 1 to November 15	3 066 66	× 15	46 000
Total		52	\$300 000

In determining the amount of such insurance to carry, the businessman should consult an insurance representative. He will find it advisable to prepare a list of items that are customarily considered as fixed charges, and to make an estimate of his normal profit, taking into consideration past experience and future expectations. When such an estimate has been made, a record should be kept of the method of computing the estimate so that these figures can be submitted in justifying a claim.

Features of Burglary and Robbery Insurance. Many businesses, especially stores, need protection from loss due to burglary, robbery, theft, and larceny. Some policies provide for (a) divided coverage or limited coverage, (b) blanket coverage, or (c) full blanket coverage. To understand these coverages it is necessary to read the details of the clauses in the particular policies.

Various policies provide protection from loss due to personal holdup, robbery of merchandise, robbery of safe, robbery of paymaster, messenger robbery, and interior office or store robbery. Because of the differences in the types of businesses and the methods of operating businesses the risks vary considerably. Consequently, the rates also vary considerably. Individual policies may be obtained to cover different risks, or one policy may be obtained to cover several risks. The rate on the latter type of policy will depend upon the number of risks covered.

Store owners need protection from shoplifting and therefore carry such insurance. It is often a better policy for merchants to employ a detective agency to check on shop-

lifters than it is to expect their employees to watch customers and accuse those guilty of shoplifting

Coinsurance may be obtained with various forms of burglary and robbery insurance. For instance, a coinsurance clause is often used in burglary insurance policies on open-stock merchandise. In burglary insurance, as in the case of fire insurance, usually only a limited loss is sustained at any particular time for seldom is all the merchandise stolen. The greater number of coinsurance clauses are therefore confined to smaller percentages. If the policyholder is willing, however, to insure for 90 or 100 per cent, he will obtain more complete protection at a lower rate.

Transportation and Cargo Insurance *Marine insurance*, or *transportation insurance*, has many uses. If a shipment is sent by water, the person who owns the goods will want protection against damage, theft, and complete loss. The person who owns the goods may obtain this insurance, or the company that transports them may provide it as a part of the cost of transportation. The transportation company may insure all its shipments through an insurance company, or it may assume its own risks and pay its own losses.

In sending a shipment by railway freight, the shipper need not declare the value, but if the shipment is lost or damaged, he may file a claim and recover the full amount of the loss. The insurance cost in such cases is included in the rate charged for transportation.

When a shipment is sent by express, the value need not be declared if it does not exceed \$50, for the express company assumes, without extra charge, responsibility for any loss up to \$50. It will also assume, without extra charge, responsibility for any loss not exceeding half the value of the shipment. If the declared value is greater than \$50 or greater than one half the value of the total shipment, the shipper may purchase additional insurance at 10 cents on each additional \$100 of the value.

Parcel-post packages may be insured by the Post Office Department upon the payment of an extra fee, or they may be sent uninsured.

The so-called "five and ten clause" in an automobile insurance policy refers to \$5,000 of bodily injury insurance for injury to one person and \$10 000 for injury to two or more persons in the same accident. These amounts are usually the minimum amounts for which bodily injury insurance should be carried, but it is common practice to carry \$10 000 and \$20,000 of protection. The additional protection costs only approximately 20 per cent more than the lesser protection although the amount of protection is twice as much. The reason why the additional protection costs only a small amount is that most of the damage claims for bodily injury are of small amounts.

Most claims can be settled within the limits of \$10 000 and \$20 000. If \$10 000 worth of bodily injury insurance is carried as protection against a single injury, the person who is injured can collect from the insurance company an amount not exceeding \$10,000. If more than one person is injured the total amount that can be collected cannot exceed \$20 000. The amount of the damages must be determined by a court or established by an agreement between the injured person and the insurance company. A good insurance company will take care of all legal details but if the amount of injury exceeds the amount of the insurance, the insured person will have to pay the difference.

Ordinarily it is considered wise not to carry less than \$5 000 worth of property-damage insurance. If an automobile driver who carries \$5 000 worth of property-damage insurance damages the automobile of another person or the front of a store for instance, the person whose property has been damaged may collect damages from the insurance company to the extent of \$5 000.

Insurance against such hazards as tornado, windstorm and rain is used less frequently, although the rates for such protection are low. The rates are low because the chance of loss from these hazards is relatively small.

Unless otherwise specified, the insurance on one's car covers its operation within the United States and for the purposes specified in the policy. For instance, the insurance on a car may cover the use of the car for both busi-

ness and pleasure, for business alone, or for pleasure alone. Although the insurance is always issued to an individual the policy covers a particular car and anyone operating that car. Ordinarily the policy does not cover the individual when he is operating the uninsured car of another person. In buying automobile insurance however, the purchaser can have inserted in the policy a special clause covering himself when he is operating a car other than the one insured.

Automobile insurance rates are generally considered somewhat unfair because the reckless driver, if he can obtain insurance, pays for it at the same rate as the careful driver. Furthermore, rates are based upon localities. For instance, the rates on various types of automobile insurance are not the same in Chicago and in San Francisco. Some companies have attempted to offset this unfairness by selecting carefully those whom they insure and thereby providing insurance at lower rates.

In the state of New York, careful drivers are now rewarded with lower rates for bodily injury and property-damage insurance. To those who have had not more than one accident involving property damage within the last two years, a classification known as Rate A is given. Such persons are given the basic rate, which is the lowest. To those who have had not more than one accident involving property damage and one accident involving personal injuries, a classification known as Rate B is given. Such persons are required to pay a premium that is 10 per cent greater than that paid by those in the Rate A classification. To those who have had two or more accidents involving either property damage or personal injury, a classification known as Rate C is given. Such persons are required to pay a premium that is 15 per cent greater than that paid by those in the Rate A classification. The insurance company may refuse to insure those persons who have had many accidents.

Special Store Insurance. Businessmen operating retail stores or dealing directly with the public in other ways

usually find it necessary to carry various forms of special insurance, such as insurance providing protection from loss due to the personal injury of customers. A claim may result from a customer's being injured by slipping on a floor, falling down steps, being caught in an elevator, or harmed by an employee or by some other customer. Damage claims may also result from the use of merchandise that was sold by a store. For instance, the dye in some clothing may cause a skin infection. A cosmetic may result in injury to a user. A piece of machinery may be defective and cause personal injury. Claims can result from all these cases but there is insurance available to provide protection against them.

Even though insurance is carried as protection against such claims the owner or the management has an important responsibility to prevent accidents. When an accident occurs it creates ill will. The prevention of accidents is therefore really as important as insurance providing protection against them.

Surety Bonds Surety bonds, which are used in business, are really a form of insurance. For instance, when a person employed by a bank will be required to handle money he must be bonded by a surety and bonding company. Then in case the employee later embezzles or steals money from the bank the bonding company is required to make good the loss provided the employee is not able to return the money. Some banks pay the cost of the bond but others require the employee to pay it. Bonds are issued only on the basis of reputable character. The rate is dependent upon the risk involved. For instance a person handling a small amount of money will not require a large bond and the rate will probably be reasonably low. On the other hand if the person handles a large amount of money, the bond will probably be rather large and the rate therefore higher.

Performance Bonds These bonds are also commonly used in business. They are in a sense a form of surety bond. For instance, if one obtains a contract to construct

SELF-CHECKING STUDY QUESTIONS

(Chapter VIII)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer, reread the chapter until you find the correct answer, then compare your answers with those on page 300 of this book. Refer to the printed answers only after you have made a serious effort to answer all questions, for otherwise the questions will not be of greatest value to you. If you have any incorrect answers reread the part of the chapter in which those questions are discussed.

Completion Questions

Directions Write one word in each blank space in each statement given below to make the statement complete and accurate. The first is given as a sample

- 0 A mutual insurance company is one that is owned by the policyholders
- 1 A stock insurance company is one owned and operated by the _____
- 2 Insurance which covers damage, theft, and other losses of a cargo is called marine insurance or _____ insurance
- 3 The financial instrument which provides protection for an employer against theft or embezzlement by employees is called a _____ bond.
- 4 The financial instrument which provides protection against the failure of another to perform a contract is called a _____ bond.
- 5 If a painter contracts to paint a house in the future and immediately buys paint to protect himself from a price increase in paint he is said to be _____

True-False Questions

Directions After each statement below that is true, draw a line under 'true'. After each statement that is false, draw a line under 'false'. The first statement is given as a sample.

- 0 Under group insurance all employees are insured without a physical examination true false
- 6 A businessman may be able to borrow money on his life insurance policy true false
- 7 The policyholders in a stock company may be required to pay an assessment true false

- | | | | |
|----|--|------|-------|
| 8 | The economic cycle causes business risks | true | false |
| 9 | Insurance rates are established by Federal law | true | false |
| 10 | All business buildings of the same size in the same city carry the same rate of fire insurance | true | false |
| 11 | Regular fire insurance protects a businessman from the loss of time and business due to the interruption caused by a fire | true | false |
| 12 | A policyholder must have an insurable interest in the object being insured | true | false |
| 13 | An ordinary automobile insurance policy covers the car and any person operating it legally | true | false |
| 14 | The so called five and ten clause in an automobile insurance policy refers to premium rates of five and ten dollars a thousand | true | false |
| 15 | A businessman may obtain insurance covering injury to his customers | true | false |

Multiple Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement The first is given as a sample

- 0 The amount which a businessman pays to an insurance company in the buying of insurance is referred to as the (a) premium (b) assessment (c) interest (a)
- 16 Under coinsurance the rate per thousand as compared with that of regular fire insurance is (a) higher (b) lower (c) the same ()
- 17 Coinsurance gains its advantage to the insured by encouraging (a) the carrying of less insurance at a higher rate (b) the carrying of more insurance at a higher rate (c) the carrying of more insurance at a lower rate ()
- 18 After a fire has damaged some goods the goods are (a) immediately the property of the insurance company (b) still the property of the original owner until an adjustment is made (c) the property of the salvage company ()
- 19 The kind of automobile insurance covering damage to other person's property is (a) bodily injury (b) property damage (c) collision ()
- 20 The railway express company insures without extra charge all shipments the value of which does not exceed (a) \$50 (b) \$100 (c) \$200 ()

PRACTICAL PROBLEMS

(Chapter VII)

Complete the following problems. If you are doubtful about decisions reread the chapter. After you have completed the exercises you will find suggested solutions on page 304 of this book. If your answers do not follow the suggested solutions reread your text then write your answers again.

- 7A. The following are the details of a fire insurance policy with a 90 per cent coinsurance clause

Value of property	\$22 000
Insurance carried	19 000
Loss	6 000

Compute the amount that will be paid by the insurance company.

- 7B. In Illustration No. 47 on page 143 is a table constructed for coinsurance clauses. Assume that each policy carries a 90 per cent coinsurance clause but that all the other facts remain the same. Compute the amounts for the last two columns.
- 7C. If a business carries \$200 000 worth of business interruption insurance under Plan 2 explained on page 145, how much insurance could be collected weekly because of business interruption?
- 7D. A business concern wishes to carry \$200 000 worth of business interruption insurance. Assume that its business is divided as follows: 20 per cent in May, 20 per cent in June and approximately 6 per cent in each of the other months. Construct a table similar to the one at the top of page 146 showing how the amounts of insurance should be distributed weekly to provide adequate coverage. Consider May and June to be 9 weeks.

CHAPTER VIII

FINANCIAL RECORDS NEEDED IN BUSINESS

Purpose of the Chapter. Under conditions of modern competition, a business cannot succeed indefinitely unless it follows sound methods of management. One of the most important aspects of business management is the use of adequate financial records. Using financial records means not only the preparation of them but also the interpretation of them.

A knowledge of accounting is a valuable asset to every businessman. It cannot be assumed, however, that everyone who reads this chapter will have a knowledge of accounting. The information presented here is not based upon the assumption of such a knowledge. The purpose of this chapter is largely to point out the necessity for financial records, to give examples of them, and to demonstrate their use. The following are some of the questions that will be answered.

1. What financial records are needed?
2. How can accounting records be used for managerial control?
3. What information is needed daily?
4. What information is needed monthly?
5. What information is needed yearly?
6. What information is needed for income-tax purposes?
7. What records are needed for social security taxes?

Use of Accounting Records. No business can be operated successfully unless books are kept and accounting statements are prepared. No one should start in business without a knowledge of bookkeeping or the aid of someone who has such a knowledge. Some of the information that a business manager should expect from accounting records is as follows

- 1 Kinds and values of assets
- 2 Amount of cash sales
- 3 Amount of cash received from credit customers
- 4 Amount of credit sales
- 5 Amount of C.O.D. sales
- 6 Amount of cash deposited in the bank
- 7 Amount of cash withdrawn from the bank
- 8 Amount of debts that are owed by the business
- 9 Amount owed to the business
- 10 Bills that are paid
- 11 Total amount of expenses
- 12 Amount of merchandise bought
- 13 Transportation charges paid
- 14 Amount sold by each salesperson
- 15 Profit or loss
- 16 Percentage of profit or loss

Sales accounts receivable payments on account expenditures and cash balances should be tabulated daily. The information listed above should be compiled monthly or at least semiannually. Modern accounting records are not difficult to keep up to date. Machines, special books and files can be utilized for this purpose.

Double-entry bookkeeping is the accepted standard in modern business. It is distinguished from *single-entry bookkeeping* by the use of offsetting entries to record each transaction. The totals of all offsetting entries must always balance. Double-entry bookkeeping provides a better proof of correctness than single-entry bookkeeping.

Control Through Accounting Records. The study of the financial records is the main means of control in the management of a business. Businessmen use the statement of profit and loss and the balance sheet as part of the means of controlling their operations. Every business should have these two statements prepared no less than once a year but preferably every six months or even every month. In many cases they are prepared every month.

Let us consider the grocery business that is operated by Mr. H. J. Brooks. The statement of profit and loss of this

business is shown in Illustration No 50 It provides Mr Brooks with an analysis of the results of his business opera-

H J BROOKS
STATEMENT OF PROFIT AND LOSS
FOR SIX MONTHS ENDING DECEMBER 31 194-

<i>Income from Sales</i>			
Sales			24 956 34
<i>Cost of Merchandise Sold</i>			
Mdse Inventory July 1	2 165 49		
Purchases	20 504 73		
Total Cost of Mdse. Available for Sale	22 670 15		
Less Mdse Inventory December 31	3 495 35		
Cost of Merchandise Sold			19 174 80
Gross Profit on Sales			5 781 54
<i>Operating Expenses</i>			
Salaries and Wages	2 630 00		
Advertising	332 15		
Donations	25 00		
Supplies Used	50 65		
Miscellaneous Office Expense	34 75		
Telephone and Telegraph Service	47 50		
Delivery Expense	305 15		
Taxes and Insurance	160 05		
Rent	600 00		
Heat, Light, Water	141 12		
Loss from Bad Debts	270 15		
Interest Paid	60 00		
Repairs and Depreciation	150 00		
Other Expense	122 23		
Total Operating Expenses			4 964 78
Net Profit			816 78

Illustration No 50—A Profit and Loss Statement

tions during a period of six months ending on December 31 The information reported on this statement was obtained from the accounting records The statement discloses the fact that a net profit of \$816 78 was made during the six month period

Illustration No 51 is a balance sheet that was prepared at the same time as the statement of profit and loss The purpose of the balance sheet is to show the condition of the business on December 31 According to this statement the net worth or capital of Mr Brooks is \$3 638 50 On July 1 his net worth had amounted to \$3 612 37 During the six months between July 1 and December 31 Mr Brooks withdrew \$790 65 for his own purposes If he had

H J BROOKS
BALANCE SHEET
DECEMBER 31, 194-

<i>Assets</i>			
<i>Current Assets</i>			
Cash	620	90	
Notes Receivable	43	50	
Accounts Receivable	614	00	
Merchandise Inventory	2,475	35	
Total Current Assets			4,753 *8
<i>Deferred Charges</i>			
Supplies	89	50	
Insurance	44	00	
Total Deferred Charges			83 50
<i>Fixed Assets</i>			
Equipment	500	00	
Less Depreciation Reserve	105	00	
Total Fixed Assets			695 00
Total Assets			\$ 5,542 58
<i>Liabilities</i>			
<i>Current Liabilities</i>			
Notes Payable	649	50	
Accounts Payable	971	*5	
Total Liabilities			1,623 *8
<i>Proprietorship</i>			
H J Brooks, Capital, July 1		2 618 67	
Net Profit	818 78		
Less Withdrawals	190 65		
Net Increase in Proprietorship		28 18	
H J Brooks Capital, December 31			\$ 5,542 58

Illustration No 51—A Balance Sheet

not made these withdrawals, the net worth would be \$790 65 more

The following is a list of items of information that was prepared by Mr Brooks on December 31. Similar information is obtained from the records every day. This list gives information on cash receipts, cash payments, cash deposited in the bank, and cash balance

Total cash received	\$ 50 57
Cash sales	40 15
Cash received on accounts	10 42
Credit sales	16 10
Purchases on account	72 04
Payments for purchases (made by check)	30 46
Payments for miscellaneous expenses (made with cash)	3 12
Cash deposited in bank	47 45
Bank balance	630 90

Interpreting Financial Statements The simple financial statements that have just been presented are not always sufficient to enable the manager to interpret the condition of the business. An accountant can prepare numerous ratios that will help to analyze the business. For instance he may compute a ratio to show the relationship between current assets and current liabilities. Such a ratio helps to determine the ability of the business to pay its current debts. For example if a business has \$3 of current assets for every \$1 of current liabilities it is apparent that the business is better able to pay its liabilities when they become due than it would be if the ratio were two to one or one to one. There is no ratio that can be set as a standard because some types of businesses do not require as large a ratio as others.

Another important ratio is the relationship between sales and cost of sales, an analysis of which is usually handled by an accountant. The manager of the business must understand something about accounting in order to understand these figures. For instance even though the businessman may not be sufficiently familiar with accounting procedure to prepare the financial statements he should be able to look at them and understand the figures. As an example assume that during one year the cost of sales amounted to 80 per cent of the gross sales and that during the next year the cost of sales amounted to 85 per cent of the gross sales. Obviously therefore the manager should be concerned with figuring a way of reducing the cost of sales or of increasing the selling price. Otherwise the trend indicates that eventually net profit will be eliminated.

Quite often it is important to compare the results of one year with those of the previous year. For instance the profit and loss statement of one year is tabulated alongside the profit and loss statement of the preceding year or the statements of several years. At a glance one is then able to make a comparison of various items for two or more years. Similar comparisons are made of balance sheet items for two or more years. For example Illustration No 52 shows a comparative balance sheet of Mr H J Brooks. It

H. J. BROOKS
COMPARATIVE BALANCE SHEET
DECEMBER 31 191-, AND JUNE 30, 191-

<i>Assets</i>	December 31		June 30	
Current Assets				
Cash	630 00		755 22	
Notes Receivable	43 50		59 41	
Accounts Receivable	614 00		693 57	
Merchandise Inventory	2 495 23		4 012 73	
Total Current Assets		4 753 73		5 558 43
Deferred Charges				
Supplies	29 50		34 73	
Insurance	44 00		49 00	
Total Deferred Charges		83 70		103 73
Fixed Assets				
Equipment	800 00		700 00	
Less Depreciation Reserve	105 00		175 00	
Total Fixed Assets		695 00		525 00
Total Assets		5 448 73		6 179 16
Liabilities				
Current Liabilities				
Notes Payable	640 50		605 72	
Accounts Payable	974 25		940 31	
Total Liabilities		1 615 75		1 625 43
Proprietorship				
H. J. Brooks, Beginning Capital	3 812 57		3 629 50	
Net Increase in Proprietorship	26 33		918 25	
H. J. Brooks, Ending Capital		3 639 50		4 547 75

Illustration No 52—A Comparative Balance Sheet

is obvious that during the six months ending June 30, the business has been in a better condition than it was during the six months ending December 31. The total liabilities are approximately the same, but the total assets are greater. The capital, or proprietorship, of Mr. Brooks is therefore greater.

On comparative statements of profit and loss it is helpful to show, by means of percentages, the relationship of the various items for one year to the sales for that year. For instance, Illustration No 53 shows the latest profit and loss statement of Mr. H. J. Brooks with such percentages. If such a statement is prepared each year, the manager is able to make a definite analysis of the operations of the business from year to year. For example, if the per-

	SALES UNDER \$25,000		SALES \$25,000 TO \$40,000		SALES \$40,000 TO \$60,000	
	Group Average	Profit Makers	Group Average	Profit Makers	Group Average	Profit Makers
NUMBER OF STORES REPORTING	47	30	33	28	29	24
NET SALES	100 00%	100 00%	100 00%	100 00%	100 00%	100 00%
COST OF GOODS SOLD	66 84%	63 14%	68 35%	67 99%	70 26%	69 53%
MARGIN	33 16%	34 86%	31 65%	32 01%	29 74%	30 47%
EXPENSE						
Salaries Management and Buying	3 21%	2 87%	2 0%	2 56%	2 99%	2 97%
Salaries Selling	12 46%	11 97%	10 74%	10 52%	9 8%	9 37%
Salaries Office	1 %	1 8%	1 74%	1 %	1 64%	1 54%
TOTAL SALARIES	17 44%	16 66%	15 13%	14 79%	14 45%	12 88%
Office Supplies and Postage	0 23%	0 23%	0 45%	0 44%	0 45%	0 46%
Advertising	0 74%	0 69%	0 83%	0 69%	1 0%	1 00%
Donations	0 09%	0 09%	0 11%	0 13%	0 09%	0 09%
Store Supplies	0 29%	0 27%	0 24%	0 23%	0 32%	0 32%
Telephone and Telegraph	0 63%	0 65%	0 43%	0 41%	0 55%	0 36%
Losses on Notes and Accounts	0 35%	0 3%	0 63%	0 53%	0 54%	0 52%
Delivery Expense (incl deliv wages)	1 54%	1 93%	1 70%	1 50%	1 83%	1 78%
Depreciation Delivery Equipment	0 30%	0 30%	0 35%	0 31%	0 34%	0 26%
Depreciation Furniture Fix and Tools	0 53%	0 49%	0 44%	0 35%	0 30%	0 29%
Rent (incl taxes ins depr and int.)	5 09%	4 90%	3 50%	3 65%	3 50%	3 24%
Repairs	0 23%	0 23%	0 25%	0 17%	0 13%	0 19%
Heat, Light, Water Power	1 00%	0 91%	0 85%	0 85%	0 43%	0 79%
Insurance (inc on bldg incl in rent)	0 68%	0 65%	0 63%	0 60%	0 35%	0 36%
Taxes (taxes on bldg incl with rent)	0 57%	0 59%	0 77%	0 79%	0 57%	0 54%
Interest on Borrowed Money	0 25%	0 23%	0 25%	0 25%	0 27%	0 23%
Unclassified	0 40%	0 36%	0 39%	0 3%	0 63%	0 66%
TOTAL EXPENSE (Int. on invest. not incl.)	31 06%	29 92%	27 26%	26 34%	26 15%	25 12%
EARNINGS ON SALES	2 10%	4 94%	4 39%	5 67%	3 59%	5 35%
Cash Disc. and Int. Rec'd (pctg. on sales)	1 10%	1 16%	1 23%	1 31%	1 15%	1 15%
TOTAL EARNINGS	3 20%	6 10%	5 61%	6 93%	4 74%	6 50%
Credit Sales (percentage of total sales)	19%	34%	42%	43%	50%	51%
Days Credit Bus. on Books —End of Year	45	48	54	50	65	65
Capital Turn Times	2 29	2 95	2 29	2 33	2 65	2 84
Stock Turn Times	1 94	1 91	2 36	2 43	2 56	2 83
Owning Real Estate	13%	13%	9%	7%	17%	13%

Hardware Retailer

Illustration No 54—Operating Costs of Hardware Stores

Records for a Small Business. A small business, especially a retail store, does not need elaborate records. A retail store can use the cash register as a basis for obtaining most of the information for its financial records. Models of such records can be obtained from the manufacturers of some cash registers. Some associations, such as oil dealers, plumbers, and dentists, have standard forms that they recommend for their members.

When a cash register is used, it is common practice for each sales clerk to prepare a daily balance slip, the two sides of which are shown in Illustration No 56. In addition to this daily balance slip, a summary is made. The two sides of this slip are shown in Illustration No 57.

A simple system of record-keeping based upon the cash register can be learned easily by a person who is not

familiar with accounting. A knowledge of accounting is however, helpful in keeping such a set of records.

It is usually possible to hire someone to come in daily, weekly, or monthly to prepare the records and the financial statements that are necessary. If such a plan is followed, the daily summary slips, as well as certain other information, are kept. These slips are then turned over to the bookkeeper who is hired to prepare the records and the statements. Summary slips are kept by chain-store managers, filling-station operators, and other businessmen.

on October 22 1935

**Daily Summary Statement
of Register Totals**

DEBITS	AMOUNT	
	Dollars	Cents
A	23	65
B	29	10
C	21	35
E	47	30
H		
K		
TOTAL	120	40
Amount of State Com.		
Special Credits		
Net to Cash	30	00
Change	30	70
Paid Out	6	15

SALES TOTAL

DAILY SUMMARY STATEMENT OF INCOME FROM CASH SALES SLIP

Time	Item	Amount	Time	Item	Amount
9:05			1:05		
9:10			1:10		
9:15			1:15		
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This type of report is not only commonly used in filling stations, but is also commonly used in all types of businesses which operate branches. The manager of the branch not only gets an accurate picture of what has happened during the day, but the central organization also is kept informed of the operations. Many of the reports used for such purposes are much more complicated.

Ratio Analysis. From the various records and reports prepared for a business, it is possible to make certain ratio analyses that are helpful in the management of the business. Illustration No. 59 shows a ratio analysis for various types of wholesalers and retailers that was prepared by Dun and Bradstreet, Incorporated. Such ratios are of interest to the businessman because he can compare his business with others. For instance, the ratio of current assets to current debts is computed by dividing the total

Line of Business	Current Assets to Current Debt (Ratio)	Net Profit on Net Sales (Per Cent)	Average Collection Period (Days)	Net Sales to Inventory (Times)
WHOLESALESA				
Automobile Parts, Accessories	3.33	1.80	19	5.2
Butter, Eggs, Cheese	2.76	0.47	26	21.3
Drugs Drug Sundries	3.47	1.24	45	6.3
Dry Goods	2.81	2.05	65	7.3
Electrical Parts, Supplies	2.36	1.69	55	8.1
Fruits and Produce, Fresh	2.66	0.76	25	26.0
Furs Skins	3.23	2.36	64	10.5
Groceries	3.12	0.92	31	8.6
Hardware	3.53	2.69	53	3.9
Hosiery	3.60	0.93	56	8.2
RETAILERS				
Clothing, Installment	3.83	3.42	172	7.4
Clothing Men's and Boys'	2.90	3.65	...	3.9
Department Stores	3.31	2.66	...	6.0
Furniture, Installment	3.90	5.41	214	6.2
Lumber	3.26	2.04	87	4.7
Shoes, Men's and Women's	3.15	2.53	...	3.6
Women's Specialty Shops	3.02	3.12	...	9.6

Dun & Bradstreet Inc.

Illustration No. 59—A Ratio Analysis

amount of such assets as cash accounts receivable and merchandise by the total amount of such liabilities as accounts payable and notes payable. If a businessman has such comparative ratios prepared for his own business each month or each year he is kept aware of his financial condition.

Depreciation. Every businessman should recognize the problems that result from the decrease in the value of property through use. For example, a filling-station operator buys a pump that costs \$200. He knows from experience that at the end of five years the pump will not be worth any more than its value as junk, about \$25. He estimates therefore that it will wear out at the rate of \$35 a year. This is a common way of figuring depreciation, although there are various other more complicated methods.

The general term that is applied to such a decrease in the value of an asset is *depreciation*. Property may also decrease in value because of *obsolescence*, that is, the asset may become out of date, or it may become inadequate for a particular purpose. For all practical purposes, however, any decrease in the value of an asset can be considered depreciation. A cash register, for instance, may wear out gradually, or it may become inadequate because the business has expanded and a larger register with more complicated tabulations is required.

The loss due to depreciation is very real, although it usually cannot be computed definitely. Any businessman who fails to recognize depreciation is failing to observe good business principles. When equipment is worn out, it must be replaced. If money is not available to replace the equipment, the business enterprise may be handicapped seriously.

The depreciation of assets is part of the cost of doing business. For example, a contractor who is constructing a large building buys shovels and a concrete mixer. He expects the shovels and the concrete mixer to be worn out by the time the building is completed. The cost of the building will therefore include, in addition to such expenses as salaries and wages, supplies and materials, the cost

of the shovels and the concrete mixer. The shovels and the concrete mixer represent assets at the time they are bought, but at the end of the construction process when they have been worn out, they will constitute an expense.

The United States Bureau of Internal Revenue sets up what are considered to be fair rates of depreciation for various types of assets. The following table shows the probable useful life of some typical assets and the rates of depreciation that are considered reasonable for them.

Type of Asset	Probable Useful Life	Rate of Depreciation
Hotel dining room furniture	12 years	8 $\frac{1}{3}$ %
Carpets in theaters	8 years	12 $\frac{1}{2}$ %
Money counting machines	10 years	10%
Sewing machines	10 years	10%
Addressing and mailing machines	15 years	6 $\frac{2}{3}$ %
Automatic scales	15 years	6 $\frac{2}{3}$ %
Wrapping machines	10 years	10%
Automobiles	4 years	25%
Adding machines	10 years	10%
Billing machines	8 years	12 $\frac{1}{2}$ %
Office desks	15 years	6 $\frac{2}{3}$ %

Illustration No 60—Reasonable Rates of Depreciation

The rates indicated in this table are those that the United States Bureau of Internal Revenue has found reasonable in allowing deductions for income tax purposes. In computing the profit of a business for each year, the manager must take into consideration the fact that the assets have worn out to some extent. This depreciation charge should be considered as an expense. Illustration No 61 is an example of the schedule used in a Federal income-tax return for reporting claims for depreciation.

Schedule E—EXPLANATION OF DEDUCTION FOR DEPRECIATION CLAIMED IN SCHEDULES C, D, F, AND G									
Kind of property if building, also method of deprecia- tion	Quantity	Cost or other basis	Depreciable basis at end of year	Depreciation de- ducted for allowable in prior years	% Depreciation used in this year	Estimated depreciation for entire life of property	Estimated depreciation for entire life of property	Estimated depreciation for entire life of property	% Depreciation allowed in this year
Addressing machine	1 34	125 00		54 35	1 34	15 yrs	10 yrs		11 67
Typewriter	1 34	100 00	100 00	100 00		5 yrs			
Adding machine	1 33	125 00		90 00	62 50	10 yrs	6 yrs		12 50
Office desk	1 38	50 00		3 33	43 34	15 yrs	14 yrs		3 33

*Illustration No 61—Federal Income Tax Deductions
for Depreciation*

The need for the replacement of an asset should be foreseen, and a reserve fund should be created to take care of the loss in value. Suppose, for example, that a merchant who has been using a small cash register finds that his business has expanded to the point where he needs a larger cash register with several drawers. The cash register that he is using would probably last several more years, but it would not serve the business satisfactorily. Because of changes in design and other improvements, this type of machine has gone out of style. The merchant therefore finds that he cannot obtain from the sale of the machine as much as the machine is actually worth according to its condition. If he has predicted the loss in value, however, and has accumulated a reserve fund to take care of it, he should have enough money available to pay the difference between the value of the old machine and the cost of a new one.

Registers. The accounting records provide information on such items as insurance, fixed assets, and real property, but the accounting records do not provide the detailed information that is needed with regard to these assets. Special ruled forms that are referred to as registers are used for keeping the detailed information on these items. For instance, a businessman may have insurance policies on equipment, merchandise, trucks, buildings, plate glass, and various other items. He therefore needs to know such information as the face of each policy, the amount of the insurance expense to be charged off each month, the date of expiration of each policy, and the like. Illustration No. 62 shows a card from an equipment register. Illustration No. 63 shows an insurance policy register. These registers provide supplementary information that is helpful to the bookkeeper and to the manager of the business.

Keeping Records Safe. The financial records, including the accounts of customers and all other vital information, should be kept safe. They should be protected from such hazards as fire and theft. Many records, such as the accounts of customers, would not be stolen, but they could

[illegible]

Illustration No 62—A Card Record of a Fixed Asset

easily be destroyed by fire. In every office, therefore, there should be a fireproof safe or vault for such records. So-called fireproof filing cabinets made of sheet metal with insulated walls are not always sure protection against fire. They will withstand heat; but if the building burns and something heavy falls upon such a cabinet, the cabinet will be crushed.

Unusually valuable documents, such as notes, deeds, leases, mortgages, and contracts, should be placed where they are secure from theft or fire. Many of these are often placed in bank safe-deposit boxes if there is no adequate protection in the office. An ordinary fireproof file often is not safe because it may collapse during a fire.

Date of Policy	Folio	Name of Company	Property Insured	Amount	Expiry	Premium
Jan 2 1943		Royal	Office Equipment	500	Jan 2 1943	75.00
2 1943		Liberty Mutual	Stock Insurance	1000	Jan 2 1943	10.00
Feb 1 1943		Harvard	Hotel Stock	2000	Feb 1 1943	75.00
March 1 1943		Homeowner's	Auto Equipment	2500	March 1 1943	25.00

Illustration No. 62. An Insurance Policy Record

Illustration No 63—An Insurance Policy Record (Left Page)

Income-Tax Records. The Federal income-tax law requires every business to keep satisfactory records so that the true income and expenses can be reported. Preparation of an income-tax return for a small business is relatively simple. The information needed for an income tax return of a business can be obtained from any good set of business records kept under the double-entry method. The income-tax form and the sheet of instructions accompanying the form will provide most of the information needed. Illustration No. 64 shows an example of the detailed reports that must be included in the income-tax return of a business.

Schedule D—PROFIT OR LOSS FROM BUSINESS OR PROFESSION									
									\$ 9,750 12
1. Total receipts (state nature of business or profession)									
COST OF GOODS SOLD									
2. Labor	\$	2,300	00	OTHER BUSINESS DEDUCTIONS					
3. Materials and supplies		115	00	3. Salaries not included on Labor (do not deduct wages or master's unpaid)	\$	522	18		
4. Merchandise bought for sale		1,620	19	10. Interest on business and business		261	00		
5. Other items (state below)		302	49	11. Taxes on business and business property		1,002	42		
6. The primary is a improvement of year		1,050	00	12. Losses (state below)		100	50		
7. Total (lines 2 to 6)	\$	5,387	59	13. Bad debts (state from sales or services)		375	00		
8. Less inventory at end of year		865	10	14. Depreciation on business and business (state below)		72	17		
9. Net cost of goods sold (line 7 minus line 8)	\$	4,522	49	15. Rent, repairs, and other expenses (state below or on other schedule)		2,060	05		
									\$ 4,292 32
									\$ 8 815 81
									\$ 934 32
Enter "C" or "M" on lines 4 and 8 to indicate whether salaries are included on cost, or cost or profit, whichever is proper.									
16. Total before tax (line 9 plus line 15)									
17. Plus profit (for line 1) (line 16 minus line 1) (see instructions)									

Illustration No. 64—Federal Income Tax Profit and Loss Statement

Federal Withholding Tax. Besides the social security taxes which are described later, business employers are required to withhold a part of the wages of each employee. The amount of the tax depends upon the wages earned and the rate prescribed by law. Through this process the employer collects for the Federal government part or all the income tax of the individual at the source. The employer

INSURANCE POLICY RECORD

Show My E paid each												Amount Carried Forward
Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	
												10 20
15	15	15	15	15	15	15	15	15	15	15	15	20 40
1 70	1 70	1 70	1 70	1 70	1 70	1 70	1 70	1 70	1 70	1 70	1 70	52 08
	2 08	2 08	2 08	2 08	2 08	2 08	2 08	2 08	2 08	2 08	2 12	7 12
		2 56	2 56	2 56	2 56	2 56	2 56	2 56	2 56	2 56	2 62	

Illustration No. 65—An Insurance Policy Record (Right Page)

must keep an accurate record of the wages paid and the tax collected. Special forms are used for reporting the tax collection when it is turned over to a governmental agency.

Social Security Taxes Under the Federal Social Security Act the employer must keep a detailed record of the compensation paid to every employee. The information required is as follows:

- 1 The employee's name, address, and social security number
- 2 His occupation
- 3 The gross amount of his earnings, the time of payment, and the period of service covered by each payment
- 4 The amount of his taxable wages
- 5 The amount of the employee's tax withheld from his wages

The Social Security Act also requires that any employer subject to tax under the Act must keep such permanent records as will provide the following information:

- 1 The total amount of remuneration payable to employees. The following amounts must be shown separately: (a) the total remuneration payable for excepted service (employment not covered by the Act); (b) the total remuneration payable for service performed outside the United States; and (c) the total taxable remuneration payable.
- 2 The amount of contributions paid into state unemployment funds. The following amounts must be shown separately: (a) the contributions of the employer and (b) the contributions of the employees.
- 3 The information required on the prescribed return and the total tax liability.

The record in Illustration No. 65 shows the form required in reporting wages paid. In addition to such records, an individual record must be kept for each employee.

2. The pay-roll period, the time worked, the regular earnings, and the excess earnings for overtime. In this particular illustration it is assumed that employees are paid twice each month. There are consequently twenty-four lines so that an entry can be made for each of the twenty-four paydays during the year. At the end of each quarter, there is a line provided to record quarterly totals
3. All deductions for the employee's income tax, state unemployment compensation, and group insurance. If other deductions are made besides the ones listed, additional columns could be included in the record.
4. The net amount paid to the employee, including the number of the check that was used in making payment.
5. The taxable earnings under the various titles of the Social Security Act.
6. The totals at the end of each quarter and at the end of the year. This information facilitates the preparation of quarterly and annual reports.

Every employer must furnish to each of his employees a written statement or statements showing the wages paid to the employee during the year. Each statement must be suitable for permanent retention. It may cover one, two, three, or four quarters of the year. Each statement must be furnished to the employee not later than the last day of the second calendar month following the period covered by the statement. Each statement should be retained as a permanent record by the employee.

P. H. 10-1080	DATE	REGULAR EARNINGS				EXCESS EARNINGS				DEDUCTIONS				NET PAID		CHECK NO.	REMARKS
		WEEKS	DAY	MONTH	YEAR	WEEKS	DAY	MONTH	YEAR	FED. INC. TAX	STATE UNEMP. COMP.	GROUP INS.	OTHER	REGULAR	EXCESS		
Jan 5	10	10	10	10	10									10.00			
Jan 12	10	10	10	10	10									10.00			
Jan 19	10	10	10	10	10									10.00			
Jan 26	10	10	10	10	10									10.00			
Feb 2	10	10	10	10	10									10.00			
Feb 9	10	10	10	10	10									10.00			
Feb 16	10	10	10	10	10									10.00			
Feb 23	10	10	10	10	10									10.00			
Feb 28	10	10	10	10	10									10.00			
MAR 5	10	10	10	10	10									10.00			
MAR 12	10	10	10	10	10									10.00			
MAR 19	10	10	10	10	10									10.00			
MAR 26	10	10	10	10	10									10.00			
APR 2	10	10	10	10	10									10.00			
APR 9	10	10	10	10	10									10.00			
APR 16	10	10	10	10	10									10.00			
APR 23	10	10	10	10	10									10.00			
APR 30	10	10	10	10	10									10.00			
MAY 7	10	10	10	10	10									10.00			
MAY 14	10	10	10	10	10									10.00			
MAY 21	10	10	10	10	10									10.00			
MAY 28	10	10	10	10	10									10.00			
JUN 4	10	10	10	10	10									10.00			
JUN 11	10	10	10	10	10									10.00			
JUN 18	10	10	10	10	10									10.00			
JUN 25	10	10	10	10	10									10.00			
JUL 2	10	10	10	10	10									10.00			
JUL 9	10	10	10	10	10									10.00			
JUL 16	10	10	10	10	10									10.00			
JUL 23	10	10	10	10	10									10.00			
JUL 30	10	10	10	10	10									10.00			
AUG 6	10	10	10	10	10									10.00			
AUG 13	10	10	10	10	10									10.00			
AUG 20	10	10	10	10	10									10.00			
AUG 27	10	10	10	10	10									10.00			
SEP 3	10	10	10	10	10									10.00			
SEP 10	10	10	10	10	10									10.00			
SEP 17	10	10	10	10	10									10.00			
SEP 24	10	10	10	10	10									10.00			
SEP 30	10	10	10	10	10									10.00			
OCT 7	10	10	10	10	10									10.00			
OCT 14	10	10	10	10	10									10.00			
OCT 21	10	10	10	10	10									10.00			
OCT 28	10	10	10	10	10									10.00			
NOV 4	10	10	10	10	10									10.00			
NOV 11	10	10	10	10	10									10.00			
NOV 18	10	10	10	10	10									10.00			
NOV 25	10	10	10	10	10									10.00			
NOV 30	10	10	10	10	10									10.00			
DEC 7	10	10	10	10	10									10.00			
DEC 14	10	10	10	10	10									10.00			
DEC 21	10	10	10	10	10									10.00			
DEC 28	10	10	10	10	10									10.00			
JAN 4	10	10	10	10	10									10.00			
JAN 11	10	10	10	10	10									10.00			
JAN 18	10	10	10	10	10									10.00			
JAN 25	10	10	10	10	10									10.00			
JAN 31	10	10	10	10	10									10.00			
FEB 7	10	10	10	10	10									10.00			

11

Signature

Witness

Official

Notary Public

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SELF-CHECKING STUDY QUESTIONS (Chapter VIII)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer, reread the chapter until you find the correct answer, then compare your answers with those on page 300 of this book. Refer to the printed answers only after you have made a serious effort to answer all questions for otherwise the questions will not be of greatest value to you. If you have any incorrect answers, reread the part of the chapter in which those questions are discussed.

True-False Questions

Directions After each statement below that is true, draw a line under "true." After each statement that is false, draw a line under "false." The first statement is given as a sample.

- | | |
|--|-------------------|
| 0 Bookkeeping records should provide information as to the kinds and values of assets | true <u>false</u> |
| 1 Bookkeeping records should provide information as to the amount of merchandise purchased | true false |
| 2 Single entry bookkeeping records provide the best proof of the correctness of records | true false |
| 3 A profit and loss statement may be prepared every month | true false |
| 4 If the cost of goods sold is 80 per cent of net sales, it is more favorable than if it were 75 per cent | true false |
| 5 A subsidiary report of accounts receivable is one that shows more detailed information than is shown on the balance sheet | true false |
| 6 In a retail store the cash register may be used as an important source of bookkeeping information | true false |
| 7 It is necessary to record some bookkeeping information daily even though the owner of a small business may have a bookkeeper prepare records monthly | true false |
| 8 The ratio of current assets to current debts is computed by dividing the amount of cash into the amount of accounts payable | true false |
| 9 Depreciation is the term which refers to a loss by fire | true false |
| 10 Every employer must keep a detailed record of the amount paid to each employee | true false |

Multiple Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement. The first is given as a sample.

- 0 The accepted standard type of bookkeeping record is (a) single entry (b) double entry (c) triple entry (b)
- 11 Sales should be recorded or tabulated (a) monthly (b) daily (c) weekly ()
- 12 Cash received on account should be recorded or tabulated (a) monthly (b) daily (c) weekly ()
- 13 Operating expenses include (a) cost of merchandise (b) purchases (c) rent ()
- 14 A balance sheet shows (a) assets and liabilities (b) income and expense (c) purchases ()
- 15 The best ratio of current assets to current liabilities is (a) 2 to 1 (b) 3 to 1 (c) 1 to 2 ()
- 16 Depreciation is an (a) expense (b) asset (c) profit ()
- 17 A reasonable net profit (earnings or net operating profit) for a successful grocery store is (a) 6 per cent (b) 10 per cent (c) 3 per cent ()
- 18 The retail store that is likely to have the greatest gross margin of profit is (a) a hardware store (b) a meat store (c) a grocery store ()
- 19 Records that should especially be kept in a fireproof place are (a) letters (b) purchase invoices (c) notes ()
- 20 Reasonable total net earnings of a profitable hardware store would be (a) 6 per cent (b) 10 per cent, (c) 15 per cent ()

PRACTICAL PROBLEMS

(Chapter VIII)

Complete the following problems. If you are doubtful about decisions reread the chapter. After you have completed the exercises you will find suggested solutions on pages 304, 305 and 306 of this book. If your answers do not follow the suggested solutions, reread your text, then write your answers again.

- 8A Mr. J. A. Watkins, who operates a grocery store, reports the following income and expenses for the year:

Total sales \$28 150.34
 Cost of goods sold \$21 654.80
 Salaries and wages \$3 000
 Advertising \$156.10
 Donations \$123.05

Supplies used \$90.45
 Office expense \$33.15
 Telephone and telegraph service \$41

CHAPTER IX

BUDGETING IN BUSINESS

Purpose of the Chapter It is unwise and unprofitable to purchase or to produce more goods than can be sold within a reasonable time. *To do so results in tying up capital.* In planning purchases or production the manager of a business must therefore take into consideration sales expectations. On the other hand it is unwise to sell goods in excess of the possibilities of supply. Loss may arise from the ill will created by disappointed customers. Sales purchases and production must therefore be correlated. An additional problem is the providing of capital and cash at the proper time to prevent unnecessary borrowing. This chapter will attempt to answer such questions as the following:

- 1 What procedure should be followed in preparing a budget?
- 2 How is a budget used in controlling a business?
- 3 What is a good cash budget?
- 4 Why is it necessary to make adjustments in the budget?

Need for Budgeting In its simplest form a budget is an estimate of sales, expenses, purchases and cash. In other words it means financial planning. Some people have the impression that because a business is small there is no need for budgeting because the manager or owner can keep everything in his head. Some businesses are so large that it is absolutely necessary to prepare a detailed budget and follow it carefully. In a small business it is equally as important but the problem is much simpler than in a large business. In a large business there are usually several executives who contribute to the preparation of the budget but in a small business it is usually prepared by one man who is either the owner or the bookkeeper. The preparation of a budget will tend to prevent overbuying and spend

ing too much money, it will help to anticipate when there may be a shortage of cash and a necessity for borrowing. In general, it enables the owner to look ahead and plan for the future.

Procedures in Budgeting. The actual procedures in budgeting will depend on the type of business. For a retail store the process is principally one of budgeting sales, expenses, purchases, and cash, but for other types of businesses it is more complicated. The following is the relative order of procedure for preparing a complete budget including a departmentalized business.

- 1 The estimate of sales is based upon past experience and future expectations. As will be explained later, there is more than one method of making this estimate.
- 2 The advertising budget is based upon the expected sales and the amount that can be afforded in promoting new products and in opening new territories.
- 3 If the business is a manufacturing one, the production plans should be based upon the expected sales of the individual products. It is therefore necessary to take into consideration the production capacity and the equipment needed.
- 4 The purchasing requirements are based upon expected sales and production. Purchases must be made far enough in advance to allow time for production. It is therefore necessary to be familiar with the times of the year when the sales are greatest.
- 5 In some manufacturing businesses it is necessary to anticipate the labor requirements. The budget of labor must therefore be based upon the production requirements. (This is especially true when labor is scarce.)
- 6 The budget of administrative costs, office costs, and the cost of supplies must be based upon all the previously mentioned factors.
7. The mass budget is made up after all the preceding budgets have been made.
- 8 The cash budget, which is explained later in this chapter, is a budget that shows the manager of the business

what cash balance he can expect at any particular time. Such a budget is necessary to anticipate borrowing.

An analysis of the preceding procedure will show that most of the individual budgets rest upon sales. At some times however in some types of businesses either the production capacity or the financial capacity must be determined first. The sales and all other estimates are then based upon this budget.

It can also be seen that the traffic manager, the office manager, the employment manager, and the engineer in a large production plant must be acquainted with all the individual budgets because their departments are affected by the budget requirements. The small businessman, obviously will not have such a detailed budget as that described previously. He will in all cases however, be concerned with budgeting sales, purchases, expenses, and cash.

Control Through Budgeting. Accounting records of some kind are necessary in order to provide the information needed in budgeting. Because of the intricate business relations in modern civilization, budgeting has become extremely important. A study conducted by the United States Department of Commerce reveals the fact that stores that budget their financial operations are more successful than stores that do not budget. The stores that are most successful are those that (a) keep double-entry bookkeeping records, (b) have their accounts audited by an experienced accountant, (c) take an inventory of merchandise more than once a year, and (d) operate under a financial budget.

Illustration No. 67 shows a sample budget that Mr. Brooks prepared after the close of his business on June 30. His budgeting process consisted in (a) tabulating the items from his statement of profit and loss, (b) computing percentages on the basis of the total sales, (c) comparing his experience with the experiences of other grocers by using the standard percentages of a large group of others, (d) estimating for the next six months each item on the statement of profit and loss on the basis of his past experi-

ence and his plans for the future, and (e) calculating the percentages of his estimates to see how his budget compared with standard conditions. After computing his estimated percentages, he might have found one of his figures to be considerably out of line with his previous experience or with the standard percentage. He would then have deemed it advisable to revise the budget in this respect and to try to operate within the new limit.

The operations of the business should be checked periodically, preferably monthly but in some cases weekly, to determine whether the business is making a profit and

H J BROOKS

BUDGET FOR SIX MONTHS ENDING DECEMBER 31 194—

Income Expense Profit	Amounts For Past Six Months	Percentages of Sales	Standards for Comparison	Amounts Budgeted for Next Six Months	Estimated Percentages
Total Income from Sales	\$24 956 34	100 0%	100 0%	\$32,000 00	100 0%
Cost of Merchandise Sold	19 174 80	76 8	81 7	26 166 00	81 8
Gross Profit on Sales	\$ 5 781 54	23 2%	18 3%	\$ 5 834 00	18 2%
Salaries and Wages	\$ 2 630 00	10 5%	8 5%	\$ 2 500 00	7 8%
Advertising	352 15	1 3	.8	800 00	1 1
Donations	25 00	.1	.1	35 00	.1
Supplies Used	80 65	.3	.4	75 00	.2
Misc. Office Expense	34 75	.1	.2	52 00	.1
Telephone and Telegraph Service	47 50	.2	.2	48 00	.1
Delivery Expense	305 15	1 2	1 4	295 00	.9
Taxes and Insurance	160 00	.7	.7	160 05	.6
Rent	600 00	2 4	1 9	500 00	1 6
Heat, Light, Water	147 12	.6	.6	147 16	.5
Loss from Bad Debts	270 16	1 1	.7	224 00	.7
Interest Paid	60 00	.3	.1	60 00	.2
Repairs and Depreciation	150 00	.6	.6	150 00	.5
Other Expense	122 23	.5	.4	122 23	.4
Total Operating Expenses	\$ 4 964 76	19 9%	17 6%	\$ 4 708 44	14 7%
Net Profit	\$ 816 78	3 3%	7 7%	\$ 1 125 56	3 5%

Illustration No 67—An Income and Expense Budget

whether the budget is being followed. If the budget is not being followed closely enough to ensure a profit, it may be necessary to reduce some items of expense or to find new ways of promoting business.

Control of Expenses After a businessman has a sufficient amount of income available to operate his business

successfully, he must next control his expenses actively and carefully. Financial statements, ratio analyses, and charts will help him to do so, but it may be helpful for him to compare his figures with those of other businessmen.

The information in the following table was compiled by the United States Department of Commerce to show the average percentages for various types of expenses incurred by retail stores of several kinds. For instance, this study discloses that the rent of grocery stores averages 27 per cent of the net sales of such stores.

Item	Percentage of Net Sales				
	Grocery Stores and Grocery Food Markets	Drug Stores	General Stores	Furniture Stores	Department Stores
Rent	27	47	28	32	30
Heat, light, and power	8	13	3	8	7
Taxes and licenses	7	14	8	10	8
Insurance	3	2	3	3	7
Interest	6	5	4	10	7
Telephone and telegraph service	3	4	2	3	4
Boxes, wrapping paper and other packing materials	4	.3	3	3	3
Postage	1	.3	.04	1	.3
Maintenance and depreciation of delivery equipment	9	5	3	18	2
Depreciation other than that on delivery equipment; repairs	6	10	3	13	.5
Collection costs	7	1	.3	11	1
Bad debts	23	79	17	3	63
Advertising	4	7	4	10	17

Illustration No. 68—Average Percentages for Various Expenses

Figures such as these can be obtained for practically every type of business and should be used for comparison. In addition, other tables can be obtained from such sources as the National Cash Register Company, the Harvard Bureau of Business Research, and various trade associations.

Illustration No. 69 is a table showing a comparison of the operating expenses, the gross margin, and the net profit

of various kinds of independent grocery stores. The businessman should compare such information with similar information gathered from his records.

Item	Service Grocery Stores	Cash Grocery Stores	Complete Food Markets
Salaries and wages (including the owner's)	95%	65%	129%
Advertising	8	10	8
Donations	1	1	1
Supplies	4	3	6
Office expense	2	2	8
Telephone and telegraph	2	1	2
Delivery	14	4	22
Taxes and insurance	7	5	6
Rent	19	13	14
Heat, light and water	6	4	7
Loss on bad accounts	7		5
Interest paid	1	1	2
Repairs and depreciation	6	6	9
All other expenses	4	4	6
TOTAL OPERATING EXPENSES	176%	119%	225%
GROSS MARGIN	183%	157%	229%
NET PROFIT	77	38%	4%

From Operating Expenses Merchants Service
Bureau of the National Cash Register Company

Illustration No. 69—A Comparison of Operating Expenses and Profits of Independent Grocers

Sales Budget. The sales budget is strictly a forecast of the sales for a month, a few months, or a year. Estimated sales may be computed on the basis of sales territories, salesmen, branch offices, departments, or particular commodities. Sometimes independent estimates are made on all these bases, and, after some compromises, a final sales budget is compiled. Sometimes sales estimates are prepared with the idea of developing sales quotas for salesmen and territories. These estimates provide a goal for the sales department, as well as a basis for preparing the merchandising, purchasing, and other operating budgets.

Illustration No. 70 shows sales estimates determined in three different ways for the same company. As the three sets of estimated figures are not the same, someone must be responsible for combining them into one satisfactory estimate that can be followed.

BUDGET BASED ON ANALYSIS OF SALESMEN

Salesmen	Sales 1938-39	Estimate 1939-40
R J Mason	\$ 17,836	\$ 19,000
T L Wilson	17,419	18,000
J H Lancey	23,562	22,000
M O Burns	22,147	22,000
F R Jacobs	21,349	22,000
J O Kinsey	20,418	20,000
Total	\$122,731	\$123,000

BUDGET BASED ON ANALYSIS OF DEPARTMENTS

Departments	Sales 1938-39	Estimate 1939-40
Department A	\$ 36,142	\$ 40,000
Department B	23,456	25,000
Department C	63,133	66,000
Total	\$122,731	\$131,000

BUDGET BASED ON ANALYSIS OF PRODUCTS

Products	Sales 1938-39	Estimate 1939-40
Electric Ranges .	\$ 32,142	\$ 34,000
Electric Heaters	10,116	10,000
Electric Fans .	9,463	9,000
Electric Lamps	10,468	10,000
Electric Refrigerators	60,542	65,000
Total	\$122,731	\$128,000

Illustration No 10—Three Ways of Budgeting Sales

Factors That Influence the Sales Estimate. Numerous factors influence the making of the sales estimate. General business conditions have an important bearing, although one concern may enjoy good business while another, at the same time and under the same economic trend, may suffer a decline in business. If a good harvest and favorable prices for the produce are anticipated in a certain section, there should be good prospects for selling farm machinery in that section. A retail store located in such an area should expect good business. A flood or a drought may affect certain businesses adversely but others favorably. These are examples of some of the influences that should guide one in making a sales estimate.

Merchandising and Purchasing Budgets. The merchandising and purchasing budgets, which are prepared after the sales budget, must be closely correlated. The kinds of stock to have on hand and the time when they should be available are determined. Maximum and minimum supplies are established. Purchases are planned, and information is passed on to the financial department so that the financial requirements can be estimated. Sources of supply are checked, and delivery dates are scheduled. The production department and the receiving department are notified. Requisitions and orders are tentatively planned. Orders are sometimes placed in advance, subject to cancellation later, or minimum orders are placed, subject to increase later.

Advertising Budget. Advertising should be kept within some reasonable bounds, for it is a fallacy that sales will always be in direct proportion to advertising. In other words, if the estimated sales are pretty well known, it would be unwise to spend an unusual amount for advertising. Such a plan might result in a loss. On the other hand, a special advertising campaign, properly planned, might increase the sales of a certain product, and the advertising budget would consequently have an influence on the sales budget. These two budgets should therefore be planned together. Likewise, the person in charge of finances should be aware of the plans for advertising in order to control

those expenses and to have the necessary cash at the proper time. Illustration No 71 shows an advertising budget based upon estimated sales.

Cash Budget. Budgeting cash is sometimes referred to as providing working capital. Working capital comes from either or both of two sources: (a) from the income of the business or (b) from borrowing. When money is borrowed it must eventually be paid back. In the cash budget therefore, borrowed money should be included as a special item under receipts. When it is to be repaid, it should be included in the cash budget under disbursements.

The form in Illustration No 72 was prepared as a result of a survey made by the Metropolitan Life Insurance Company. It may be used for the cash forecast or budget of a small business. This type of budget, however, should be prepared by every business regardless of size. It should show the anticipated necessity of borrowing and the possibilities of repaying borrowed money. For instance, it is possible for a business to make plenty of profit but at some particular time during the year the business may not have enough cash for its operations and may therefore have to borrow.

Administering the Budget. After having budgeted sales, purchases, and the other items indicated above, it is relatively simple to estimate the profit or the loss. If a loss is indicated the manager should review the expenses to determine what can be done to reduce them. If such economies are not apparent and the forecasted sales volume appears as high as it can be conservatively anticipated, he will have to consider drastic adjustments, such as a reduction of rent, the elimination of part of the personnel, or the elimination of certain purchases.

Economies can be effected by budgeting the inventories carefully to avoid the buying of unnecessary new merchandise and the carrying of an excess quantity of old items. The careful control of the inventories will conserve the cash supply. Purchasing should be checked carefully with the inventories to avoid unnecessary expenditures.

Items	Sales	Advertis- ing	Per centage	Estimated Sales	Estimated Advertis- ing	Per centage
	1938-39	1938-39	1938-39	1939-40	1939-40	1939-40
Shoes	\$ 5 197	\$ 123	2.37%	\$ 5 500	\$ 125	2.27%
Women's dresses	7 578	271	3.56	7 500	250	3.33
Women's millinery	2 142	100	4.67	2 000	100	5.00
Men's clothes	8 203	195	2.38	9 000	175	1.94
Men's hats	1 506	80	5.32	1 500	60	4.00
Bedding	5 073	183	3.60	6 000	175	2.92
Furniture	6 238	198	3.14	6 500	200	3.08
Household furnishings	5 072	125	2.46	4 500	120	2.67
Household equipment	6 231	120	1.93	6 250	130	2.08
General advertising		625			625	
Total	\$47 300	\$1 990	4.20%	\$48 750	\$1 950	4.00%

Illustration No 71—An Advertising Budget Based upon Estimated Sales

CASH FORECAST

3 months beginning April 1

	April	May	June
Cash on hand at beginning of month	\$ 2 325	\$ 1,425	\$ 2 085
Receipts			
Collections from accounts receivable	15 026	16 502	15 227
Other receipts	2 142	3 061	2 059
Total receipts	\$17 168	\$10 653	\$18 185
Total Cash Available	\$19 493	\$21 078	\$20 270
Disbursements			
Pay roll	\$10 462	\$10 701	\$10 829
Production materials	5 800	6 000	6 411
Supplies and expenses	216	107	320
Construction and plant additions	500		
Other disbursements (re payment of loan etc.)	1 000	3 000	500
Total disbursements	\$18 008	\$18 009	\$18 060
Estimated cash at end of month	\$ 1 485	\$ 3 069	\$ 2 210

Policyholders Service Bureau - Mutual Life Life Co. - New York N. Y.

Illustration No 72—A Cash Budget

Adjusting the Budget No budget or quota can be followed exactly. One must remember that a budget is an estimate and that it therefore cannot be exact. It is merely a guess of what may happen. If the sales increase more than was anticipated all elements of the budget can be adjusted particularly purchasing. If the sales decrease more than was anticipated economies must be put into effect before it is too late. The possibility of looking ahead prevents serious losses. Watching the budget carefully enables one to make adjustments before it is too late.

SELF-CHECKING STUDY QUESTIONS (Chapter IX)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer reread the chapter until you find the correct answer then compare your answers with those on page 300 of this book. Refer to the printed answers only after you have made a serious effort to answer all questions for otherwise the questions will not be of greatest value to you. If you have any incorrect answers reread the part of the chapter in which those questions are discussed.

True False Questions

Directions After each statement below that is true draw a line under true. After each statement that is false draw a line under false. The first statement is given as a sample.

- | | |
|--|-------------------|
| 0 In a small business the owner or manager prepares the entire budget | <u>true</u> false |
| 1 The most important item in the budget is purchases | true false |
| 2 If there is a bad drought in the area served by a feed store the store can expect a decrease in business | true false |
| 3 Sales may be partially estimated on the basis of past sales | true false |
| 4 After a budget has been set it should be followed exactly for a year | true false |
| 5 A sales budget is a forecast of sales | true false |

- | | |
|--|------------|
| 6 If sales decrease below expectations purchases should be increased | true false |
| 7 In a small business budgeting includes estimating sales expenses purchases, and cash | true false |
| 8 A decrease in sales may require an increase in production | true false |
| 9 Advertising may influence the sales budget | true false |
| 10 Periodical financial reports are necessary to good budgeting | true false |

Multiple-Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement. The first is given as a sample

- | | |
|--|-------|
| 0 Budgeting means (a) planning operations by estimating income and expenditures, (b) speculation, (c) the cash expenditures of a business | (a) |
| 11 The first step in a budget is usually to (a) estimate cash, (b) estimate sales, (c) estimate labor | () |
| 12 The thing most likely to affect a sales budget of a farm machinery dealer in a farm community is (a) factory production, (b) other retail sales in the community, (c) crop conditions | () |
| 13 Advertising is most likely to be estimated primarily on the basis of (a) sales, (b) production (c) available newspaper space | () |
| 14 A cash budget (a) shows the cash on hand at a particular time (b) predicts the cash balance in advance, (c) shows past cash expenditures | () |
| 15 A purchasing budget is most likely to be based on (a) sales and production (b) cash in the bank account, (c) warehouse space | () |

PRACTICAL PROBLEMS

(Chapter IX)

Complete the following problems. If you are doubtful about decisions, reread the chapter. After you have completed the exercises you will find suggested solutions on pages 306 and 307 of this book. If your answers do not follow the suggested solutions, restudy your text, then write your answers again.

- 9A. Refer to the figures in the first column of Illustration No. 67 on page 185. Using these figures as a basis, prepare a budget for Mr. Brooks for the six months ending June 30. Assume that his expected sales for the six months are \$21,000, the cost of merchandise sold will remain 76.8 per cent of the sales, the supplies used will be .3 per cent of the sales, and the loss from bad debts will be 1.1 per cent of the sales, but that all the other expenses will be exactly as they were during the past six months. (Disregard the figures in the fourth column of the illustration.) Indicate for each item its estimated percentage of sales.
- 9B. Draw a form for a cash budget like that shown in Illustration No. 72 on page 191. Starting with the balance at the end of June, enter the budgeted figures for July, August, and September, assuming that the receipts and the disbursements for July will be the same as those for June, but the receipts and the disbursements for August and for September will be 10 per cent less than those for June.
- 9C. Refer to the three budgets on page 188 showing sales estimated on the bases of salesmen, departments, and products. Assume that the estimated sales of products are considered correct and that these figures are based upon the retail prices. How much cash must be available for purchases if the wholesale purchase prices of these items are 70 per cent of the retail prices and the following is the schedule of purchases for the year?

Electric Ranges one fourth in January, one fourth in August, one fourth in September, one fourth in December

Electric Heaters one fourth in January, one fourth in October, one fourth in November, one fourth in December

Electric Fans one half in May, one fourth in June, one fourth in July

Electric Lamps one fourth in January, one fourth in May, one fourth in September, one fourth in December

Electric Refrigerators one fourth in May, one fourth in July, one half in December

CORRESPONDENCE AND DISCUSSION PROBLEMS

(Chapters VII, VIII, and IX)

If you are a regularly enrolled student in the United States Armed Forces Institute you are entitled to the assistance from an instructor by correspondence if you wish such assistance. These problems are for that purpose. However you are not obligated to send in these assignments. If you want suggestions on your work write out your answers to these assignments and send them to the United States Armed Forces Institute as instructed on page v of this book.

If you are working in a class under an instructor the assignments may be used for discussion or for written outside work.

- 1 Why is the risk of style changes so important in a business selling women's clothing?
- 2 Explain the differences in ownership between the mutual insurance company and the stock insurance company.
- 3 Is there any advantage in carrying fire insurance for a greater amount than the actual value of the property?
- 4 Under a coinsurance fire insurance clause why are the rates per thousand dollars of insurance lower than they are under ordinary insurance?
- 5 Why is business interruption insurance a desirable form of insurance for some businesses?
- 6 What does a profit and loss statement show?
- 7 What does a balance sheet show?
- 8 What is meant by the term *depreciation*? Is there any difference between depreciation and obsolescence or inadequacy?
- 9 What types of businesses must file Federal income tax returns?
- 10 Why is the cash budget so important from the point of view of the treasurer of a company?
- 11 Why is budgeting considered such an important factor in management?
- 12 Let us assume that two months after a budget was established a checkup on the budget shows that the actual sales are 20 per cent less than those which were anticipated. What would you recommend to the manager of this business?

CHAPTER X

BANKING AND FINANCIAL PROBLEMS

Purpose of the Chapter Every businessman large or small must establish some banking relationship. This relationship usually involves the safekeeping of deposits, the handling of a checking account, and the borrowing of money. No attempt is made in this chapter to discuss the details of writing checks and handling other minor transactions, but an attempt is made to answer many questions some of which are as follows:

- 1 What are the factors that determine the selection of a bank?
- 2 What kind of financial advice can be obtained from a bank?
- 3 Upon what bases are loans made by banks?
- 4 What are the different ways in which money can be borrowed?
- 5 Does the bank or the depositor suffer a loss if a bad check is presented for collection?

Selecting a Bank. Convenience in banking facilities is important, although safety should not be sacrificed to convenience. When deposits are guaranteed, one bank is essentially as safe as another. There are, however, ways of determining the safety and conservativeness of a bank. The most common means is through an analysis of the bank's financial statements. The ratio of cash and government bonds to the deposits in one bank may be compared with the same ratio for another bank. The bank that has the higher ratio is essentially the safer and more conservative bank.

Even though the deposits of a bank may be insured in some way, a person should not be relieved from the responsibility of selecting a bank that meets his requirements. He should not trust to luck or depend entirely on conven-

ience of location. Integrity is the important factor to be considered in choosing a bank. He should therefore choose a bank that is sound, that has officers who are known for their honesty and that, above all, meets his needs. If he utilizes normal banking facilities, it is important for him to deal with bankers whom he can consult confidentially and who will give honest advice.

Deposit Insurance. In spite of some unfortunate occurrences during periods of economic depression, the majority of banks are safe and sound. Most banks now are insured by The Federal Deposit Insurance Corporation. Each depositor in a bank that carries this insurance is protected from loss to the extent of \$5 000. The fact that most banks now carry this insurance discourages depositors from withdrawing their funds in a panic. The insurance therefore serves as a stabilizing influence.

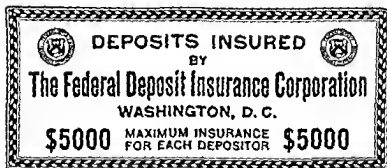


Illustration No 73—A Sign Announcing That a Bank's Deposits Are Insured

Size and Type of Bank. In some communities there is an advantage in placing an account in a small bank because the officers and the personnel of such a bank learn to know each customer and appreciate his business. The advantages of a small bank, however, are sometimes offset by those of a larger bank. Dealings with a large bank may be impersonal, but such a bank can offer facilities that are not otherwise available. Small banks may not be able to make a loan under a favorable rate or may not be able to make

as large a loan as is desired. The businessman who has many dealings in other cities may find the larger bank more efficient because it may have better connections in those cities and can therefore handle transactions more conveniently.

Federal Reserve Regulations. State and Federal laws limit banks, according to their classification, in the types of loans that can be made. State banks are governed by the laws of their respective states. Members of the Federal Reserve System are governed by the following restrictions:

1. The Federal Reserve Board has power to fix the percentage of loans that the banks in any Federal reserve district can make with bonds and stocks as collateral. No member of the Federal Reserve System may, however, lend to any person or business an amount in excess of 10 per cent of its capital and surplus.
2. Member banks may make loans secured by staple agricultural products, goods, wares, or merchandise.
3. Loans secured by direct obligations of the United States, such as Government notes or bonds, may be made to individuals, partnerships, or corporations.
4. No member bank is permitted to lend money to an affiliated organization or to individuals in an affiliated organization. For instance, a bank may hold the controlling interest in an investment company, but the bank is not permitted to lend money to this affiliated organization or to individuals in that organization. It may not accept securities of an affiliated organization as collateral for a loan if the loan exceeds 10 per cent of its capital and surplus.
5. Loans can be made on improved real estate, including improved farm land. Such a loan must not, however, exceed 50 per cent of the actual value of the real estate offered for security and must not extend for a period greater than five years. Only a limited amount of the funds of a member bank may be used for loans on real estate.

Financial Advice The best place to seek financial advice and to obtain loans is always the banking institution with which contacts have already been established. If credit relations have been established with the bank the obtaining of a loan should be simple. Most bankers will give advice to those who apply for credit.

A wise banker will not make a loan to anyone if he believes that the loan cannot be repaid or if he thinks that the repayment of the loan will place an undesirable hardship upon the borrower. Regardless of the character of the borrower or the security that has been pledged to the bank the making of a loan in such a case may result in financial disaster. The businessman should therefore consider carefully any necessity for a loan.

Types of Loans A loan may be classified according to the basis on which it is made. It may be based (a) on confidence (b) on security or (c) on the indorsement of another person. If the conditions for a loan seem unusually favorable the banker may not require security but will rely upon the borrower's character and capacity to pay. Conservative commercial banks however usually require security in some form of property. In other words this property is pledged to the bank as a guarantee that the loan will be repaid according to the agreement. This property can be taken over and sold by the bank to protect itself in case the borrower cannot pay the loan when it is due. In a sense an indorsement is a form of security. If a person indorses a note in order to aid a borrower in obtaining money the indorser is held responsible for the payment of the note in case the borrower is unable to pay.

Commercial Loans Warehouse receipts and mortgages on real property are common forms of security. For instance a person who wishes to borrow from a bank may have placed one thousand bushels of wheat in a grain elevator. If he has receipts for this wheat he may turn these receipts over to the bank thus transferring to the bank the right of ownership to the wheat in case he does not pay his loan when it becomes due. Likewise a person

FINANCIAL STATEMENT

INDIVIDUAL—PROPR STORESHIP
MANUFACTUR NO OR MERCANTILE LINES

next John Fordham

Cincinnati Wholesale Tea Company 751 Main Street, Cincinnati, Ohio

STATEMENT FOR

[illegible]

Illustration No 74—The First Page of an Application for a Loan

may borrow money on real estate and grant a mortgage that gives the lender the right to take possession of the real estate if the loan is not paid

Borrowing on Bonds and Stocks. Bonds and stocks are frequently used as security for loans. When stocks or bonds

are pledged as security the loan is commonly spoken of as a *collateral loan*. In other words the bonds and stocks serve as the collateral.

Any stock or bond that has a value can usually be used as collateral. Some banks prefer stocks and bonds that are listed on recognized exchanges because such bonds and stocks can be marketed easily if they must be sold to pay the loan. A bank will ordinarily lend about 50 per cent of the value of a good stock or a good bond. Suppose for example that a loan of \$200 is required for three months and that the bank charges 6 per cent interest. Good bonds or stocks with a market value of approximately \$400 may be used as security. In making the loan the bank will deduct the interest in advance as follows:

Amount to be paid to bank in three months	\$200 00
Six per cent interest deducted in advance	3 00
Amount of cash given to borrower	\$197 00

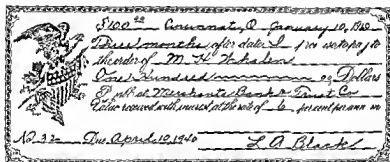


Illustration No 75—An Ordinary Note

In this example the interest charge is actually more than 6 per cent, for \$3 is being charged for the use of \$197 for three months. If the loan is not repaid in three months, the bank has the privilege of selling the securities to obtain the \$200. Suppose that at the end of three months this loan has not been repaid. It may be possible for the borrower to have the loan renewed by paying \$3 interest in advance and by signing a new note to take the place of the old one. Or he may pay \$100 and sign a new note for \$100 after paying \$1.50 interest in advance on the new loan.

If the securities are sold to protect the bank, more or less than the amount of the loan may be obtained, depending upon the fluctuation of the market prices of the securities. Suppose that, in the preceding example, nothing is paid on the loan and the bank sells the securities at the end of the three months for \$300. The additional \$100 will go to the person who obtained the loan. If the securities are sold for only \$175, however, the person who obtained the loan still owes the bank \$25.

Borrowing on Insurance Policies. Most insurance policies have a cash value and a loan value. These values are usually the same. An insurance policy can be used as the basis of obtaining a loan, usually at 6 per cent interest. The policy must be given to the insurance company as security, and the loan can be repaid when it is convenient. If death occurs before the loan is repaid, the amount of the loan is deducted from the payment due the beneficiary.

The amount that can be borrowed on an insurance policy depends entirely on the face of the policy and the length of time the policy has been in force. A bank will occasionally lend on an insurance policy in the same way as an insurance company.

Interest Rates. Interest rates vary according to the states and the types of lending institutions. Statutes in most states govern the interest rates of such institutions as pawnshops and loan associations. The state banking laws and the rules of the Federal Reserve System govern largely the interest rates of banks. Although the demand for and the supply of money have much influence on the interest rates on bank loans.

In nearly every state there is a *legal rate* and a *contract rate* of interest. In the absence of any agreement as to the interest rate, a bank may charge the legal rate. A special agreement may be made to permit a bank to charge the contract rate, which is limited in most states.

Illustration No. 76 shows the maximum interest rates of the various states and territories. These rates are determined by law and are changed from time to time. If an

individual wants to know the maximum rates in his state, he should consult the latest law on this subject

Computing Interest. When a short-term loan is obtained from a banking institution, the interest is usually deducted in advance. The amount that is credited to the borrower's account is therefore the amount of the loan less the interest charged. For example, on a loan of \$5,000 for ninety days at 6 per cent interest, there would be a deduction of \$75. The borrower would therefore have \$4,925 credited to his account or would receive that amount in the form of a check.

Paying a Loan. Bankers have found that borrowers will pay long-time obligations with less difficulty if some pro-

States and Territories	Legal Rate (Per Cent)	Contract Rate (Per Cent)	States and Territories	Legal Rate (Per Cent)	Contract Rate (Per Cent)
Alabama	6	8	Montana	8	10
Alaska	6	10	Nebraska	8	9
Arizona	6	6	Nevada	7	12
Arkansas	6	10	New Hampshire	6	Any rate
California	7	10	New Jersey	6	6
Colorado	6	Any rate ¹	New Mexico	6	10 ²
Connecticut	6	12	New York	6	6
Delaware	6	6	North Carolina	6	6
District of Columbia	6	8	North Dakota	4	7
Florida	8	10	Ohio	6	8
Georgia	7	8	Oklahoma	6	10
Hawaii	6	12	Oregon	6	10
Idaho	6	8	Pennsylvania	6	6
Illinois	5	7	Porto Rico	6	9 ³
Indiana	6	8	Rhode Island	6	10
Iowa	5	7	South Carolina	6	7
Kansas	6	10	South Dakota	6	8
Kentucky	6	6	Tennessee	6	6
Louisiana	5	8	Texas	6	10
Maine	6	Any rate	Utah	5	10
Maryland	6	8	Vermont	6	6
Massachusetts	6	Any rate	Virginia	6	6
Michigan	5	7	Washington	6	12
Minnesota	6	8	West Virginia	6	6
Mississippi	6	8	Wisconsin	6	10
Missouri	6	8	Wyoming	7	10

Illustration No. 76—Legal and Contract Rates of Interest

¹ When any rate is permitted for contracts, there usually is a limit on a small loan of approximately \$300 or less, although this limit may be as high as 3 per cent a month.

² When a loan is unsecured by collateral, the contract rate may be 12 per cent.

³ When the amount is more than \$3,000, the maximum contract rate is 8 per cent.

vision is made for paying off the loan at intervals instead of in one amount at the expiration of the loan period. If the average borrower is given the privilege of waiting until a specified date to pay the entire amount, he may carelessly or intentionally utilize his income for other purposes and not have available the proper amount of money when the loan becomes due. The property that was given as security may by this time have depreciated so much that the bank will not have adequate protection on its loan.

Some borrowers have a tendency to borrow money without giving specific thought as to when and how it can be repaid. They assume that, if they cannot repay a loan when it becomes due, they may renew it and continue to pay the interest without making payments on the principal. Borrowing without a definite intention and specific plan of paying off the principal is a dangerous practice for both the borrower and the lender. It will eventually result in catastrophe for those involved. The borrower will be forced into bankruptcy, the banker will be unable to collect the debt and may consequently be unable to pay his depositors.

Cost of Operating a Checking Account. Obviously, the service provided by a checking account costs money, for it must be remembered that the bank not only provides a place of safekeeping for the depositor's money but also is responsible for all the bookkeeping necessary in keeping the records up to date. Furthermore, as the checking account provides a convenient means of making payments to other persons and to business concerns, the bank must use the services of a local clearinghouse and of clearinghouses in other parts of the country. Because the bank has to pay expenses incurred in rendering all these services, it must earn something from the checking accounts. Consequently, in most communities there is a charge for small accounts. As the size of these accounts varies the tendency is to base the charge upon the actual cost of operating such an account. In states in which there is a tax on deposits and on checks, the bank may or may not pay the tax. If it pays

the tax, it must realize enough profit from the accounts to compensate for the tax as well as for other expenses involved

The clearinghouse associations in various cities and the individual banks set up charges for the handling of checking accounts. The following are examples of the charges made in one large city under a uniform plan established by the clearinghouse

*Analysis Formula for
Accounts with Balances of Less than \$500*

For accounts with balances of less than \$500, a simple form of analysis has been adopted so that each customer can readily determine for himself, on the basis of the balance he maintains, the charge if any, on his account. The analysis is applied as follows

1 Average balances

Less than \$100 Charge is \$1 a month allowance, 15 items

\$100 to \$199 Charge is based on the cost of activity

\$200 to \$299 Charge is based on the cost of activity,
5 items without charge

\$300 to \$399 Charge is based on the cost of activity,
10 items without charge

\$400 to \$499 Charge is based on the cost of activity,
15 items without charge

2 Items in excess of the number permitted without charge are to be charged for at the rate of 3 cents each, but no charge is to be recorded unless it amounts to at least 15 cents

*Analysis Formula for
Accounts with Balances over \$500*

A detailed analysis is used on accounts in this classification to determine the charges for maintaining them. The accounts are analyzed monthly as follows

1 From the average daily ledger balance for the calendar month, a deduction is made to take care of the average daily amount of float (deposited items that are in the course of collection) for the period under analysis

- 2 On the net balance thus determined, a service credit of \$1.50 a thousand dollars per month is allowed. (This is the equivalent of 24 per cent a year less 25 per cent to cover legal, cash, and bank reserves.)
- 3 The cost of operating the account and of other services is charged against the service credit according to the following schedule
 - (a) On debits to the account the following charges are made
 - First 400 items, 3 cents each.
 - All items over 400 items, $1\frac{1}{2}$ cents each
 - (b) On credits to the account the following charge is made
 - City and foreign deposited items, $1\frac{1}{2}$ cents each.
 - (c) A maintenance charge of 35 cents a month is made on each account.
 - (d) The cost of all other services rendered the depositor during the period under analysis are made against the service charge, unless such cost has been charged directly to the customer's account or has been paid in cash
 - (e) When the deduction of float in any account creates an overdraft in the net funds available for investment, an interest charge at 1 per cent above the customer's current lending rate is made
- 4 When the service credit is insufficient to cover the cost of operation and of other services, a deficiency charge to cover the indicated loss on the account is made to the customer's account at any time during the following month that the bank may consider convenient. The minimum charge so made is 15 cents a month

Reconciliation of Bank Statements. Illustration No 77 shows a typical bank statement. Not all banks use the same form, but they do use forms that are similar. For instance, all statements have a column for indicating the amounts of checks that have been drawn, another column for indicating the amounts of deposits, and another column for indicating the balance on particular days of the month.

FIRST NATIONAL BANK			
CINCINNATI OHIO			
A. M. Fallon		Account No.	11
1026 Gilbert Avenue		Date	March 31-39
DATE	DEBIT	DATE	CREDIT
	BALANCE BROUGHT FORWARD BY		1,325 61
March 1-39	122.50	March 2-39	70 00
March 4-39	30 00	March 8-39	125.50
March 8-39	86 00	March 15-39	202 75
March 11-39	141.85	March 19-39	155 00
March 14-39	18 90	March 21-39	91 25
March 16-39	60 25	March 25-39	146 00
March 17-39	39.30	March 30-39	39 62
March 22-39	159.75		
March 27-39	10 00		
March 30-39	7.05		
March 31-39	71.30		
PLEASE EXAM ME AT ONCE		BALANCE BY	March 31-39 1,407.23
IF NO CASH IS REPORTED ON PER DATE THE ACCOUNT WILL BE REMOVED FROM CONTACT			

Illustration No 77—A Bank Statement

BANK STATEMENT RECONCILIATION			
CHECKBOOK		BANK STATEMENT	
Balance	\$1,372 00	Balance	\$1,600 00
Deduct charges		Deduct checks out-	
Service charge		standing	
made by bank	2 00	#563	\$30 00
	\$1,370 00	#587	27.50
Credits to be added		#583	77.50
Deposits made but		#589	10 00
not recorded in			145 00
the checkbook	85 00		
Adjusted checkbook		Adjusted bank state-	
balance	\$1 455 00	ment	\$1 455 00

Illustration No 78—A Bank Reconciliation

be paid upon presentation As soon as the cashier of the bank certifies the check he charges the amount to the

CERTIFIED *July 5* 1912

The Public National Bank

Pay to the order of *R. E. Albert & Co.* *July 5, 1912* \$ *45.00*

Forty five and 00/100 Dollars

E. M. Gray, Cashier
J. C. Jamison

Illustration No 79—A Certified Check

depositor's account The amount cannot then be utilized for any other purpose, unless the certified check is canceled

For instance, Mr A must make a down payment of \$1,000 on the purchase of a home at the time the contract is signed He goes to Bank X and writes a check on his account in the bank The check is presented to the cashier for certification Immediately the bank impounds or earmarks in his account \$1,000 This amount is thus held for the payment of the check upon presentation to Bank X

Bank Draft. A bank draft is a check that a bank draws on funds deposited to its credit in some other bank A bank draft is a convenient means of transferring money when

FIRST NATIONAL BANK

CARDEN O. O. *JANUARY 17* 1912 No 169

Pay to the order of *R. E. Albert & Sons* \$ *500.00*

REGISTERED *RE-6627* \$ *500.00* DOLLARS

TO **FIRST NATIONAL BANK**
CINCINNATI O. O.

William H. Jackson Cashier

Illustration No 80—A Bank Draft

the individual who is making payment is not known in the part of the country to which the remittance is to be sent. He may obtain the draft by purchasing it from a bank.

For example, Mr. A, who lives in Dallas, wishes to make a payment of \$2 000 in New York City. As Mr. A is not known in New York City, his personal check will not be accepted. Mr. A therefore buys from Bank X in Texas a draft that Bank X draws on Bank Y in New York. When the draft is presented to Bank Y in New York, it is paid as any other check would be paid.

Cashier's Check. One may buy a cashier's check in somewhat the same way as a person buys a bank draft. The cashier's check is a check on the bank that issues it, payable to the person designated by the purchaser of the check. Banks also use cashier's checks to pay their own debts and expenses.

For example, Mr. B's personal check for \$1,000 may not be acceptable. He therefore purchases from Bank X a cashier's check made out to Mr. C. Mr. B pays Bank X \$1,000 plus a fee. Mr. B presents the check to Mr. C, who in turn presents it to Bank X for payment.

Collection Service. Banks provide a collection service for such items as notes, drafts, trade acceptances, checks, and interest and principal on bonds. For instance, when a note that he owns becomes due, a businessman may turn it over to his bank for collection. He may also have his bank take care of the collection of drafts, trade acceptances, and checks that he holds. The bank charges a fee for this service. Charges for the collection of checks have been explained previously.

Many bonds have on them coupons that are to be torn off and submitted for collection when interest on the bonds is due. A bank will perform this collection service. Likewise, when the principal of a bond becomes due, the bank will act as the collecting agent. Sometimes there is no charge when such collections are made locally, but in most cases there is a charge. Banks will also take care of the

collecting and the exchanging of securities such as stocks and bonds. A service charge and a shipping charge are included in the fee for handling securities. Such a charge can be deducted from the depositor's account.

Negotiable Instruments The relation of borrowing and lending centers largely around a *negotiable instrument*. A negotiable instrument is a written evidence of some contractual obligation and is ordinarily transferable from one person to another by indorsement. It is frequently referred to as *negotiable paper* or *commercial paper*.

The most common forms of negotiable instruments are (a) promissory notes and (b) checks. A promissory note is an unconditional written promise to pay a sum certain in money at a particular time or on demand to the bearer or to the order of one who has obtained the note through legal means. The one who executes a promissory note that is the one who promises to pay the amount specified in the note under the terms indicated is the *maker*. The person to whom the note is payable is known as the *payee*. A check is a written order on a bank to pay previously deposited money to a third party on demand. The person who writes the check is the *drawer*. The person to whom the check is payable is the *payee*. The bank that is ordered to pay the check is the *drawee*.

The maker of a note or the drawer of a check is unconditionally required to pay the amount specified. This obligation assumes of course that the transaction represented by the instrument has been proper and legal. The drawer of a check is required to pay the amount of the check if the drawee (the bank) does not pay it. There are however certain limitations on this rule in many states.

The person who indorses a negotiable instrument and transfers it to someone else is known as the *indorser*. The person to whom he transfers the negotiable instrument is referred to as the *indorsee*.

Bad Checks A bad check is one that is not honored when it is presented to a bank for payment. It may not be paid because there are insufficient funds in the account on

which it is drawn, or because it was written by a dishonest person who does not have an account in the bank on which it was drawn. In either case there are laws in every state that make it possible to prosecute the person who has written the check.

Ordinarily banks and business people are courteous and considerate whenever a person unknowingly writes a check


NOTICE OF PROTEST THE MARINE TRUST COMPANY OF BUFFALO, N. Y.	BUFFALO, N. Y.	
	SIR	
	TAKE NOTICE that on the <u>fifth</u> day of <u>January</u> , 19 <u>40</u> .	
	A <u>check</u> for \$ <u>25.00</u> dated <u>December 21, 1939</u>	
	Signed by <u>Harold B. Fraser</u>	
	payable at <u>The Marine Trust Company of Buffalo,</u>	
	<u>Buffalo, New York, and endorsed</u>	
	<u>by you, and due this day payment of which has been duly demanded and refused, was PRO</u>	
	<u>TESTED for non payment, and the holders look to you for the payment thereof.</u>	
	<u>X</u> <u>Harold B. Fraser</u> at <u>616 Third Avenue, Buffalo</u>	
This notice is addressed to the party whose name is "checked" above.		
Respectfully yours,  Harry Williams Deputy Cashier in and for Erie County, New York		
NOTIFY PRIOR ENDORSERS, IF ANY IMMEDIATELY		

Illustration No 81—A Protest Form

on an account in which there are insufficient funds. Both the person who drew the check and the person to whom the check was issued are notified. Ordinarily no legal action is taken if the matter is cleared up satisfactorily. On the other hand, if there is an apparent intention of fraud, the person to whom the check was issued is usually responsible for starting any legal action.

When a check or any other negotiable instrument is presented to a bank for payment but is not paid, it is returned

to the one who submitted it. Accompanying it is a form called a protest. Such a form is shown in Illustration No 81. The bank makes a charge for protesting payment. It is therefore advisable to avoid submitting to a bank any item that probably cannot be collected. It should be borne in mind that, when a bank accepts a check for deposit, it is acting only as the collecting agent until the check has been collected. If the bank cannot collect the check it deducts the amount from the account of the depositor.

Forgery and Alterations. It is illegal to forge another person's name. In other words it is illegal for one to sign another person's name unless he has been authorized to do so and unless the substitute signature is recognized as acceptable. The changing of a signature is likewise illegal. Furthermore, it is illegal to change the date, the amount, or any other significant information on any legal instrument, such as a check or a note.

Let us assume for instance, that Mr H O Jackson receives a check that has been issued to him in the name of "B O Jackson." It would be illegal for him to correct the name by erasing the "B" and inserting an "H." Mr Jackson can, however, collect the check without any difficulty. The proper procedure is for him to endorse the check, first, in the way it has been made out to him ("B O Jackson") and, second, with his correct signature ("H O Jackson").

Depositing Checks Promptly. When a businessman accepts checks in payment for merchandise or services those checks should be deposited promptly. A person who receives a check should not be negligent or cause unreasonable delay in presenting it for collection. In other words, a person who receives a check has the responsibility of cashing it reasonably promptly.

For instance, Mr A issues to Mr B a check drawn on Bank X. Mr B delays thirty days in presenting the check for payment. In the meantime Bank X has been closed because of some financial difficulty. There is some legal question in this case as to whether Mr B can force Mr A to

make a new payment because, as a result of Mr. B's negligence, the check was not presented for payment within a reasonable time. On the other hand, if Mr. B had not been negligent, Mr. A would probably be legally bound to make a new payment.

Collection Between Banks. When there are only a few banks in a city, the process of exchanging checks among them is simple. Suppose, for example, that there are only two banks in a particular city. Customers of Bank No. 1 make deposits during the day. Some of the deposits are in cash, but many of them are in the form of checks. At the end of the day Bank No. 1 has in its possession ten checks amounting to a total of one thousand dollars. These are drawn on the funds of individual depositors in Bank No. 2. A messenger from Bank No. 1 takes these checks to Bank No. 2. After an investigation discloses that the depositors who wrote the checks have enough money to pay them, Bank No. 2 approves the checks, cancels them, and either pays one thousand dollars in cash to Bank No. 1 or gives credit for that amount to Bank No. 1. If Bank No. 2 finds that any particular depositor does not have enough money to pay his check, the check is returned to Bank No. 1. Bank No. 2 follows the same procedure in connection with checks it has that are drawn on Bank No. 1. The average collections between the two banks will probably be about equal. Variations will usually not be large.

In large cities a system such as this would be cumbersome, slow, and costly. *Clearinghouses* have therefore been organized to facilitate collection between banks. A clearinghouse represents an association of banks. At a certain hour of each day clerks from all the banks meet at the clearinghouse. In most cities two clerks represent each bank. One clerk delivers the checks that the bank received during the previous day and that are to be collected from other banks. With the checks is a list showing the amount due from each bank and the total amount due on all the checks. The second clerk receives from the other banks checks that are to be collected from his bank.

A clerk from each bank then quickly determines the difference between the amount his bank owes all the other banks and the amount that all the others owe his. If his bank owes more than the amount due from other banks, it pays the difference to the clearinghouse. If the other banks owe his bank more than it owes them, the clearinghouse pays the difference to his bank. Under this system the collection between banks takes only a short time. Small banks that do not belong to a clearinghouse association have their checks cleared through a bank that is a member of the association.

The Federal reserve banks perform an important function in the clearing of checks between cities. A Federal reserve bank will accept from the member banks in its territory all checks that are to be collected from banks in other cities. These checks are sent by the Federal reserve bank to the clearinghouses in the other cities. The procedure is quite detailed, but the Federal reserve bank acts essentially as the agent of member banks in collecting checks drawn on banks in other cities.

Banks that are not members of the Federal Reserve System may, in some cases, have their checks cleared through the Federal reserve banks by a special agreement.

Some banks clear their out-of town checks through *correspondent banks*. For instance, Bank A in Chicago and Bank A in New York have arrangements for the exchange of checks. Bank A in Chicago has a check for collection on Bank B in New York. Bank A of Chicago presents this check to Bank A of New York. Through the clearinghouse procedure in New York City, Bank A of New York makes collection and either credits the proceeds to the account of Bank A in Chicago, or sends a draft, a check, or the actual funds to the latter.

SELF-CHECKING STUDY QUESTIONS

(Chapter X)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer reread the chapter until you find the correct answer then compare your answers with those on page 300 of this book. Refer to the printed answers only after you have made a serious effort to answer all questions for otherwise the questions will not be of greatest value to you. If you have any incorrect answers reread the part of the chapter in which those questions are discussed.

True False Questions

Directions After each statement below that is true draw a line under true. After each statement that is false draw a line under false. The first statement is given as a sample.

- | | |
|--|-------------------|
| 0 A service charge on checks is interest earned by the depositor | true <u>false</u> |
| 1 Any bank will meet the needs of a businessman | true <u>false</u> |
| 2 A depositor who has \$8 000 in a bank that is insured by the Federal Deposit Insurance Corporation is protected from all loss should the bank fail | true <u>false</u> |
| 3 Banks are limited in the types of loans that can be made | true <u>false</u> |
| 4 Banks which are members of the Federal Reserve System are permitted to make loans on real estate | true <u>false</u> |
| 5 When a mortgage on real estate is given as security for a loan it is known as a collateral loan | true <u>false</u> |
| 6 In making a short term loan banks usually deduct the interest in advance | true <u>false</u> |
| 7 Most insurance companies will make a loan to the holder of a life insurance policy | true <u>false</u> |
| 8 In the absence of an agreement as to the interest rate the legal rate of interest may be demanded of the borrower | true <u>false</u> |
| 9 When getting a loan the borrower should have a specific plan for paying the debt | true <u>false</u> |
| 10 Banks seldom make a charge for handling checking accounts | true <u>false</u> |
| 11 A bank statement reconciliation is made to account for the difference between the balance | |

- shown on the bank statement and the balance shown on the checkbook stub
12. The bank charges a depositor's account for the amount of a certified check when the check is presented for payment true false
13. Bank drafts may be purchased at post offices true false
14. A cashier's check is a negotiable instrument true false
15. Banks provide collection service for many items true false
16. A bank that is ordered to pay a check written by a depositor is called the drawee true false
17. When one deposits in his bank a check drawn on some other bank, collection is guaranteed by the depositor's bank true false
18. One should alter checks that he receives if they are incorrectly drawn true false
19. A businessman should deposit promptly checks received from customers true false
20. A businessman can cash a check made out to him if his name has been misspelled true false

Matching Questions

In the parentheses after each of the statements listed in Column II below, place the letter which indicates the item listed in Column I with which it corresponds. The first is given as a sample.

Column I	Column II
a Bank draft	0. The one who executes a promissory note (h)
b Cashier's check	21. A personal check whose payment is guaranteed by a bank ()
c Certified check	22. The one to whom a negotiable instrument has been transferred by indorsement . ()
d Drawee	23 The bank on which a check is drawn . ()
e Drawer	24. The person to whom a note is payable ()
f Indorsee	25. A check in which one bank draws on funds it has deposited in some other bank ()
g. Indorser	
h. Maker	
i. Payee	

PRACTICAL PROBLEMS **(Chapter X)**

Complete the following problems. If you are doubtful about decisions, reread the chapter. After you have completed the exercises you will find suggested solutions on pages 307 and 308 of this book. If your answers do not follow the suggested solutions, reread your text, then write your answers again.

10A. On the basis of the analysis formula (page 205) for computing the service charge on checking accounts, consider the following facts:

- (a) The net average daily balance (after float has been deducted) is \$800.
- (b) The number of checks written during the month is 30.
- (c) The number of checks deposited is 70.

Compute (1) the service credit, (2) the total service charge, and (3) the difference between the two items.

10B. Assume that you are in business and have an invoice for \$576.50 on which the terms are 2 per cent ten days, net thirty days. You wish to take the discount, but find it necessary to borrow money at 6 per cent until the end of the month in order to pay the invoice. You will need to borrow \$500. How much will be saved by borrowing the money for twenty days in order to obtain the discount?

10C. Assume that you borrow \$100 from a bank for sixty days at 6 per cent interest, deductible in advance. At the end of thirty days you are able to pay off the debt. The bank is willing to accept payment and to allow you credit for the remaining thirty days of interest. How much will you pay back?

10D. Consider the following figures on a bank statement:

CHECKS		BEGINNING BALANCE
No 20	\$20.00	\$1,005.20
No 21	5.00	
No 22	15.00	DEPOSITS
No 24	25.50	\$30.50
No 25	9.00	7.75
No 27	30.75	42.25
No 28	22.50	10.00
		10.00
		15.20

(a) Reconcile the bank statement, taking into consideration the following additional facts (use model on page 208):

Checks outstanding:	No 23, \$10.50
	No 26, \$52.40
Checkbook balance:	\$930.19

(b) If the checkbook balance were \$928.21, what procedure would you recommend?

CHAPTER XI

RELATIONS OF BUSINESS WITH GOVERNMENT

Purpose of the Chapter. If one expects to go into business he should have a clear understanding of the fact that government tends not only to aid business but also to control business. In other words business operates under a set of laws that both aid and control. In order for government to operate there must necessarily be taxes to finance it. There are so many different types of taxes that one's tax relations with the government are particularly important.

The purpose of this chapter is to seek answers to many questions some of which are

- 1 What rights does government grant to business?
- 2 What limitations are placed on business rights?
- 3 To what extent may we do as we wish in business?
- 4 What are the so-called fair trade laws?
- 5 What are the advantages and the disadvantages of the fair trade laws?
- 6 What departments of the Federal Government tend to influence and control business?
- 7 How do states control business?
- 8 How do the various types of taxes affect business?

Section I

Governmental Control of Business

What Is Private Property? *Private property* is the name applied to goods or rights controlled by one or more individuals. A private-property right is the right to control some goods whether they be in the form of real estate or an automobile. The right to own private property is fundamental and so essential that we ordinarily do not think of it as depending upon the consent of the members of society.

In this country the right to own property has been recognized since the first white settlers arrived

We may have the right of possession, the right of use, and the right of ownership. A person may rent a house and have the right of possession and the right of use, but he does not own the house. An individual may use a park or a street, but he does not have the right of ownership except as one citizen among many.

Various rights to property are undergoing slow but constant modification. The right to inherit property, for instance, has undergone considerable change through taxation. To some extent one loses the right of inheritance because of laws that enable the government to share in the inheritance through the process of a tax. Taxes on income also represent a change in the right of ownership. The fact that a person has earned an income is no assurance that he has the right to use all of it, he must share part of it with the government.

Limitations on the Use of Private Property. In the United States where the people theoretically grant powers to the government, the people have the right of use of private property. Society, or the government, through its right to form laws, has the power to deprive individuals of certain privileges. It therefore has the right to govern the use of property. The imposition of a tax is one of the first actions of society in governing the use of private property by individuals. Society, through its laws, may authorize the government to take property in time of an emergency such as a war, or for the public good as in the widening of a street or the building of a new highway. This right is referred to as that of *eminent domain*. When property is taken in this manner, the government must prove that the taking of the property is for the general welfare of society.

During the World War the Federal Government, when it found a need for camps in which to train soldiers, exercised its right of eminent domain by taking suitable sites and paying the owners a fair compensation. If, in such a case, the value of the property is questionable, it is established

through a court decision. If a city government needs land to widen a street, it may insist upon buying the land, it may condemn the property and through legal procedure, establish a fair price. States may exercise the right of eminent domain in taking land for the construction of roads and bridges.

The Federal Government has given railroad companies the right to obtain the possession of land when they have proved that the railroads will serve a useful purpose for society in general. For example, if a railroad company has been granted permission to extend a line from New Orleans to St. Louis, it can choose the most convenient route, establish a fair price for the property, and offer payment to the owners. If the owners refuse payment, the railroad company may bring a lawsuit to have a fair price established. The price established by the court is the one that must be accepted.

Under rules established by society, the right to property may revert to the government through fines levied as a penalty, through forfeiture due to some failure to comply with the law (for instance, the failure to pay taxes), or through the death of an owner who leaves no legal heirs.

The government also limits the rights of individuals in the use of property. Federal laws, state laws, and local laws prohibit the use of private property in maintaining a public nuisance or in promoting some unlawful enterprise. For instance, governments are permitted to seize and to sell automobiles used for transporting illicit liquor. A person can be prohibited from allowing his radio to annoy other people. An individual can be prohibited by law from permitting his cattle to trespass on or to damage other people's property. A businessman may be prohibited from using a certain kind of signboard.

Special Property Rights. Society, through its governmental agencies, grants certain exclusive privileges as a reward for services rendered it. These privileges are a special form of private property. Among the most important of these privileges are *franchises*, *patents*, and *copyrights*.

A franchise is a contract that permits a person to use public property for private profit. No individual member of society, however, has any special right to use public property except through some special grant by society. Cities frequently give private companies and individuals the right to use the streets for operating streetcars or busses, or for stretching electric power lines or telephone lines. These are temporary rights that are governed by written agreements. Such an agreement limits the use of the public property and usually specifies some compensation that must be paid to the government which granted the authority. The contract that permits the company or the person to use the public property is a franchise.

A patent is an agreement between the Federal Government and some member of society, which becomes legal evidence that the latter has developed an original article or process. A patent is an official Federal document that grants to an inventor, for a term of years, the exclusive right to make, to use, and to sell his invention under a legal form of monopoly. Through the laws of the government the patentholder can seek protection in case some other person infringes upon his right. This protection is a reward for his services in making his patent available for the general use of society. He is permitted to profit by this protection, and other members of society are prohibited, for a certain period of time, from duplicating the article or the process covered by the patent.

A copyright is similar to a patent in that it is an official Federal grant of the exclusive right to reproduce, publish,

PATENTED

December 21 1913 July 15 1919 April
5 1921 August 6, 1927

KWIKSTIK COMPANY
Chicago, Illinois

Notice of a Patent

Copyright 1932

Copyright, 1938

By SOUTH-WESTERN PUBLISHING CO
Cincinnati Ohio
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Notice of a Copyright

and sell literary or artistic work. It is not possible to copyright abstract ideas, but it is possible to copyright literary or artistic work of a physical nature.

Sometimes trade marks are copyrighted in order that they may be protected from copying. One can protect an unregistered trade mark, however, by proving the prior use of it. If he has his trade mark registered or copyrighted on the other hand, he has a better means of proving his prior use of it.

Limitations on Individual Initiative. A principle upon which our economic society is founded is freedom of initiative, that is, of one's right to control and to operate one's own enterprise. This right is, however, subject to limitation. As yet there is no law to restrain anyone from initiating a legitimate enterprise in most fields of endeavor. One can open a store, a lumber yard, a manufacturing plant, or a printing shop.

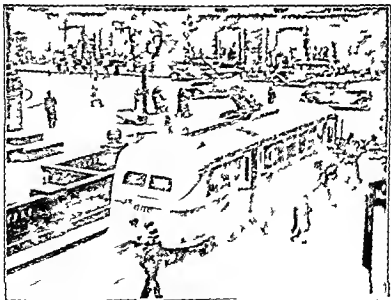


Illustration No. 81. A street scene in New York City.
Und. 11. 11. 11.

The regulation of enterprises is, however, increasing. Cities and states have exercised the right to control the number of transportation lines as a means of protection for those whose lines are already in operation. Thus, for instance, when society through a governmental agency grants a franchise to an electric railway, it protects the railway from competition.

Many of our recent state and Federal laws have tended to regulate freedom of initiative on the part of enterprises that operate unfairly toward labor, society, or competitors. The Federal and state governments have attempted to lay down certain rules within the limits of which citizens can exercise their freedom of initiative so long as they do not infringe upon the rights of others.

Society, through its governmental agencies, is gradually changing the rights of those who operate enterprises. However, except in the field of public utilities (railways, power plants and the like), there is, in general, no restriction on one's right to start a business.

Theory of *Laissez Faire*. During the early days of trade there developed a system that was referred to as mercantilism. During that time those who were engaged in business and those who were largely responsible for forming public laws were of the opinion that business could be conducted most effectively if it were regulated closely by the government. Nations therefore granted monopolies of many kinds. They regulated the relations between business operators and their workmen. They restricted importations and exportations and the use of money. There were some leaders, however, who believed that business could be conducted much more effectively by permitting each individual to operate his business to his own advantage. This theory was called the *laissez faire* theory. It was named from the French expression equivalent to our phrase, "Let one do as he pleases."

The early commerce of the United States was operated on a *laissez faire* basis. Fundamentally, commerce still operates on this basis, but with more and more regulations.

It is assumed that each person has the right to operate his business to his best advantage. The government however has stepped in to protect labor and the public and in some cases has regulated competition with the purpose of eliminating certain abuses.

Business today operates fundamentally on a competitive basis. For instance two or more merchants try to sell their goods to the same person. Each merchant tries as a matter of fact to obtain the highest price that he can although competition tends to regulate the upper limits of prices. In recent years however as will be explained later in this chapter laws have been passed permitting manufacturers to control the resale price of merchandise. Nevertheless business is still operated fundamentally on a competitive basis for even though prices in such instances are controlled each businessman must compete against others in service location and other factors.

It can be seen that although the theory of *laissez faire* is the fundamental basis of the operation of American business there is a gradual trend away from this theory. Every new governmental regulation and every new law breaks it down. For instance until recent years the buyer of foods and drugs was largely responsible for looking after his own interests. Recent legislation however requires more information to be placed upon the labels of foods and drugs and thus enables the buyer to select his merchandise more wisely.

- 1 Use taxes, which are equivalent to a sales tax and are charged when goods are bought in one state and used in another
- 2 Oleomargarine taxes, which are in a sense a license for the permission to sell the product in individual states
- 3 Chain-store taxes, which tend to reduce the number of stores that a company may operate within a state.
- 4 Discriminatory taxes on corporations doing business within the state but incorporated in another state
- 5 Discrimination against employing residents of other states or buying products from other states for local public institutions

The fair trade laws, as well as various aspects of Federal control, will be discussed later in this section

Monopolies. A monopoly is the control of the price or the production of some commodity or service. Monopolies are not necessarily undesirable, sometimes they represent very efficient forms of production. It is rather the question of control or use that determines whether or not monopolies are socially desirable.

The Sherman Antitrust Act and various other Federal laws, as well as many state laws, attempt to prevent or to control monopolies. Whenever there is a monopoly such as that which exists in the telephone and telegraph industry the Federal Government reserves the right to regulate that industry.

The Federal Government grants monopolies to railroad companies. This policy is based on the assumption that the public would not be benefited but would probably be harmed, if new railroads were built in competition with those already existing and therefore made it impossible for any of the railroads to be profitable.

The Interstate Commerce Commission establishes rates for the transportation of products and groups of products between specified points. Nevertheless the railroads compete with one another on the basis of services and conveniences. Take, for example, the railroads that operate

between Cleveland and New York. No new railroad can start operation between those points without permission from the Interstate Commerce Commission. The existing railroads, however, must compete with one another. Each may have a feature which makes that road more attractive than its competitor. One railroad may have more comfortable passenger trains than another. One may take less time to travel between the two points. Another may handle freight shipments better, although the rates that it charges are the same as the rates of the other roads. It is thus evident that railroads have a partial monopoly in that no new roads can be constructed without permission. The existing railroads, however, do compete with one another by offering better services and conveniences than their competitors.

The United States Postal Service is one form of governmental monopoly. No private enterprise is allowed to compete with the governmental postal service except in the parcel-post branch. No company, for example, can establish a service to handle first-class letters although express companies and other transportation agencies are permitted to handle shipments comparable to parcel post.

There are independent monopolies that are neither owned nor granted by the government. The Standard Oil Company at one time had practically a monopoly on world production and distribution of oil. There are claims that certain of our metal products are produced under partial monopolies. The world production of raw rubber was practically a monopoly of the businessmen of Great Britain at one time. For many years most of the raw rubber was produced by concerns owned in England. These English concerns therefore regulated the price of raw rubber. The monopoly was destroyed when new producing areas were opened and new processes were developed for producing rubber. Diamonds are produced and marketed under a very strict monopoly that regulates the supply and the price.

Under a monopoly, competition is eliminated and some of its waste is avoided. The incentive to improve services or methods changes, then, from a competitive one to a question of reducing the costs of production so that in-

comes and profits may be increased. Although under a truly monopolistic situation the price is controlled this fact does not necessarily mean that the price will be the highest possible one. It means rather that the price will be established at a point which will encourage people to buy in quantities that will produce the greatest net profit.

A monopoly under some circumstances is necessary. In many instances of governmental or private monopolies such as the postal service or railroad utilities it would be extremely wasteful if the services were duplicated in the sense in which we have a duplication of grocery stores and restaurants. The major advantage of a monopoly is the elimination of the wastes of competition.

Fair Trade Laws. Numerous so-called fair trade laws have been enacted by the Federal Government and by state and local governments. The most important of these are the Robinson Patman Act and the Tydings Miller Fair Trade Enabling Act.

The Robinson Patman Act is one that attempts to prevent discrimination in selling. It is largely the outgrowth of abuses that arose out of selling to certain preferred customers at much lower prices than to other customers. Under the Robinson Patman Act the buyer and the seller are equally guilty if the seller discriminates in price service or any other way and the buyer accepts the discrimination. For instance if a manufacturer sells to Merchant A at one price but gives a special discount to Merchant B the manufacturer and Merchant B are both guilty of violating the Robinson Patman Act.

The Robinson Patman Act permits the giving of special concessions if merchandise is bought in large quantities but there must be no special concessions between buyers who obtain the same quantity under similar conditions.

The Tydings Miller Act is a Federal act that enables the individual states to enact so-called fair trade laws in cooperation with the Federal Government. The general provisions of the individual state laws promoted by the Tydings Miller Fair Trade Enabling Act are as follows

Arguments for Fair Trade Laws. The arguments in favor of the fair trade laws enacted under the Tydings-Miller Act are as follows.

- 1 Small independent businessmen, especially independent retail druggists and other so-called "small" retailers, believe the protection of this law is necessary to keep them in price competition on well-known, business-sustaining items with larger distributors.
- 2 Fair trade laws embody for the independent retailer the idea of one price to all. The consumer feels secure in the price he pays, knowing that someone else cannot buy the same goods more cheaply at another store. This one-price-to-all idea automatically lowers sales resistance.
- 3 Fair trade laws tend to eliminate so-called "loss-leader" selling (selling an article below cost in order to attract customers). Loss-leader merchandising, it is true, has been found an effective policy in aggressive retailing. For the retailer with ample resources, it is merely a promotional measure for getting customers into the store, but it also keeps customers out of smaller stores. It has been claimed in some instances that the advertised item used as "bait" was not even available at the store or was available only in a limited quantity.
- 4 Under fair trade contracts a fair margin is planned for the price-controlled items. In this way the manufacturer gets better co-operation from the small retailer, who in turn finds he is able to meet competition on well-known brands. Manufacturers must see to it that independent retailers survive, because such distributors still do about 73 per cent of the total retail business.
- 5 Manufacturers who own a brand or a label, who have spent money in developing a demand for certain products, and who have improved quality standards have a right to protect their property (the goodwill represented by the label).

- 6 Fair trade laws affect only a small proportion of the goods bought by the consumer
- 7 Manufacturers are not given a monopoly because the fair trade laws provide that there shall be no horizontal price agreements between manufacturers. All manufacturers of similar goods must therefore compete with one another on the basis of price
- 8 Trade tends to flow through normal retail channels and not to be diverted into unnatural channels. When consumers are led out of their normal course however to buy at out-of-the-way places because of cut prices that are not available in all stores normal retail channels are not employed.
- 9 Direct governmental regulation must result if the independent businessman fails to suppress distributor monopoly (resulting from the ability to cut prices) through the operation of fair trade legislation
- 10 The promulgation and the observance of the principles of fair trade are vitally important to the preservation of the profit system and of our form of government and our civilization.
11. There can be no general prosperity without a prosperous body of distributors and distributors cannot be prosperous when they are beset by wasteful and unsound competition among themselves and by warfare which so weakens them that they cannot perform the services necessary to keep the factory wheels running
- 12 With the elimination of the independent dealer producers would have to rely upon a few large distributors. Thus they would be compelled to accept low prices for their output and receiving low prices would have to pay low wages to workers

Small distributors feel they have a just cause in their support of fair trade laws. A number of intelligent and responsible manufacturers join them. They believe that the consumer will be benefited by such legislation.

- 7 Those opposed to fair trade laws say that, because of the power of the producer to control prices these measures may lead eventually to governmental regulation of prices for the protection of the public
- 8 The consumer is more concerned with low prices than with social and economic reasons for higher prices Consumers hesitate to pay a few cents more for any item At least those consumers who are in the habit of patronizing cut rate stores will have to pay higher prices on some of their favorite items
- 9 It is expensive and troublesome for manufacturers to keep abreast of all the legal aspects of different fair trade laws as well as to keep informed on the current litigation in each state This task becomes especially irksome when the major portion of the manufacturers' distributive trade does not demand price contracts
- 10 It takes more courage than that possessed by many manufacturers to turn down the large profitable orders of mass distributors who wish to operate on a price appeal basis
- 11 For many manufacturers the ever present desire for an increased sales volume and the effectiveness of the price motive in moving large quantities of goods are strong arguments against fair trade laws
- 12 Although the proponents of fair trade laws emphasize the 'voluntary' nature of fair trade price contracts there is nothing voluntary about the requirement that distributors who do not sign such contracts must conform to the contracts of others whether or not they are generally acceptable to the trade

United States Department of Commerce. The United States Department of Commerce represents the voice of business in our Federal Government. The Secretary of Commerce is a member of the Cabinet of the President and is the President's advisor on matters affecting businessmen.

The United States Department of Commerce publishes a great deal of literature pertaining to business operations business conditions, prices production sales, management

and numerous other topics. It regularly disseminates the kind of information that has proved to be most beneficial to businessmen. Information about the services of this Department can be obtained by writing for a list of publications and services. Branches of the Department are established in several of the leading cities.



Illustration No. 84—National Bureau of Standards

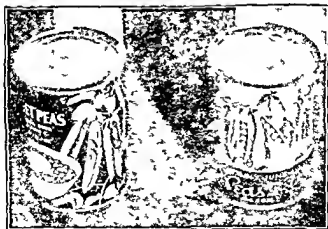
National Bureau of Standards. The principal functions of the Bureau of Standards are those that pertain to (a) the making of tests, (b) the establishment of standards, and (c) the control of weights and measures.

This Bureau has established standards for many products. If a manufacturer wishes to produce a product according to these standards, the Bureau will furnish him with the necessary information. The Bureau publishes a list of "willing to certify" manufacturers who do produce products according to its specifications. Products meeting these specifications may be marked with a label showing how they conform to the standards.

The National Bureau of Standards has also been instrumental in eliminating miscellaneous sizes and kinds of products. For instance, a few standard sizes of bolts are advocated. Bolts made according to a certain specification are interchangeable, regardless of who may have produced them. Hundreds of miscellaneous sizes have therefore been eliminated. Many other cases of standardization could also be cited.

United States Department of Agriculture. The United States Department of Agriculture administers many laws that affect the businessman. Some of the primary functions of the Department have been to standardize nomenclature, grades, and measurements. Meat, butter and egg inspection is conducted under the jurisdiction of this Department. Probably the most important functions that affect the businessman are those pertaining to grades and labels for canned foods and drugs.

Standard Grades for Canned Foods. The Secretary of Agriculture has the right to designate the grading standards for canned foods. The grades are designated as "Grade A," "Grade B," "Grade C" and "off grade." Products that are labeled "Grade A," "Grade B" or "Grade C"



Consumers Guide

Illustration No. 85—Graded Canned Foods

are up to the standards recognized by the Federal Government. Products that are designated as "off grade" are wholesome foods, though they may not measure up to recognized standards in other respects. Standards have been established for such farm products as corn, peas, beans, and tomatoes, and are rapidly being extended to other foods. Foods canned under these standards are subject to supervision and inspection by government agents.

Labels. The Food, Drug, and Cosmetic Act and the other similar acts administered by the Department of Agriculture are, of course, subject to periodic changes by Congress. The primary purpose of the Food, Drug, and Cosmetic Act is to prevent the manufacture, sale, or transportation of adulterated, misbranded, poisonous, or deleterious foods, drugs, and cosmetics in interstate commerce. Under this Act any drug sold in interstate commerce must conform to standard specifications or must be labeled to indicate how it deviates from those specifications. The labels of other medicinal preparations must show the contents and provide other information required by law. The United States Pharmacopoeia and the National Formulary are the basic sources of many of the specifications for products that are sold in interstate commerce under this Act. These agencies provide standards for the medical and the pharmaceutical professions. The standards are revised approximately every ten years. Besides the Federal regulations, many states have regulations with regard to the labeling of products.

The Tea Act and the Import Milk Act are concerned mainly with the wholesomeness of tea and milk. Standards of quality regulate the importation and the sale of these products.

The Insecticide Act is concerned mainly with the quality and the effectiveness of insecticides, fungicides, turpentine and resin. When these products are sold in interstate commerce, they must meet the requirements of the Act and must be labeled accordingly.

Federal Trade Commission. The Federal Trade Commission is the outgrowth of a demand made by competing

manufacturers for protection from unfair methods of competition. This Commission is therefore charged with the administration of most of the Federal laws having to do with fair competition. A businessman for instance may make a complaint against another on the grounds that the latter is using unfair practices in restraint of trade in order to raise prices or that he is selling an inferior product under false specifications. In such a case the Federal Trade Commission is charged with the responsibility of conducting an investigation.

Complaints to the Federal Trade Commission. A complaint may be registered with the Federal Trade Commission by an individual, a business concern or an association. A letter of complaint stating the facts in the case may be submitted. Some of the causes for complaint are adulteration, mislabeling, misleading selling schemes, false advertising, selling refinished goods as new, selling imitations of products, and otherwise misrepresenting an article to the extent that the competitor will be damaged or the public misled.

The procedure in laying a complaint before the Federal Trade Commission is outlined in the following example. Dealer A discovers that Dealer B is selling a product that he is misbranding and misrepresenting. Dealer B is able to undersell Dealer A and therefore causes Dealer A a loss of business. As Dealer B is selling his product in interstate commerce, he is subject to the jurisdiction of the Federal Trade Commission. Dealer A writes a complete letter of complaint to the Commission. The latter asks for such additional information as it needs or if the complaint is serious enough, it sends an investigator to get additional facts. The case will then be called for a hearing. If the Federal Trade Commission decides, however, that there is insufficient evidence to bring an action, or if the matter is settled without necessity for an action, the case may be dismissed. If it is called for a hearing, both dealers will be called to testify. If a decision is rendered against Dealer B, the Commission will issue an order requiring Dealer B

to cease carrying on the unfair trade practice specified in the complaint.

Reports of the Federal Trade Commission. A study of the annual reports of the Federal Trade Commission will give an idea of some of the unfair trade practices that are detrimental to businessmen and to consumers. The following is an example of a Federal Trade Commission report:

MISBRANDING PRODUCTS—ELECTRIC LIGHT BULBS

White-Lite Distributing Corporation and Others, New York City—The Commission, in a proceeding against this corporation, found that it and its manager, another respondent, sold electric light bulbs marked with substantially less than the correct number of watts, indicating that the bulbs or lamps would use less electric current to operate than they actually did use, and representing that the bulbs would therefore, be less expensive to operate than lamps of standard makes sold by competitors. For example, salesmen of White-Lite Corporation demonstrated its lamp marked "15-watt," which was actually a 27- or 28 watt lamp, against a 25-watt standard lamp of a competitor. The customer was thus led to believe that if he bought respondent's lamp, for which he paid twice the purchase price of the standard lamp, he would save in the cost of electric current the difference between the cost of operation of the 15- and 25-watt lamps, respectively. The customers purchasing "Sun-Glo" lamps from respondents thought from the marking on the lamps they were obtaining a 50-watt capacity bulb. Such "Sun-Glo" lamps were found to measure 83.6 and even 69.1 watts.

The Commission further found that Sun-Glo lamps marked 60 watts actually measured 69.8 watts and produced only 589 lumens of light, whereas a standard 50-watt lamp produced 575 lumens of light. In addition, the Commission found that to operate this Sun-Glo lamp at 6 cents a kilowatt-hour would cost \$4.19 for 1,000 hours, whereas the cost, at the same rate, for operating the 50-watt standard lamp would be only \$3 for 1,000 hours, or \$1.19 less.

The Commission ordered the respondent to cease and desist from selling and offering for sale incandescent lamps marked with other than the correct number of watts, and further to cease and desist from representing the lamps as being manufactured to comply with specifications of the United States Bureau of Standards. Respondent was further ordered to cease and desist from representing that any trade-mark used in the sale of incandescent lamps was registered in the United States Patent Office, unless such registration had actually been made.

Federal Control of Advertising. The Federal Trade Commission Act was amended to provide for Federal jurisdiction over false advertising. Under this amendment, which became effective May 22, 1938, it is unlawful for an advertiser to disseminate false advertising to induce the purchase of foods, drugs, devices, or cosmetics, or to participate in any other unfair methods of competition.

State Control of Advertising. There are numerous state laws that are barriers against dishonest advertising. Probably the most famous law is the *Printers' Ink Model Statute*, which is quoted here

Any person firm corporation or association who with intent to sell or in any wise dispose of merchandise securities service or any thing offered by such person firm corporation or association directly or indirectly to the public for sale or distribution or with intent to increase the consumption thereof or to induce the public in any manner to enter into any obligation relating thereto or to acquire title thereto or an interest therein makes publishes disseminates circulates or places before the public or causes directly or indirectly to be made published disseminated circulated or placed before the public in this State in a newspaper or other publication or in the form of a book notice handbill poster bill circular pamphlet or letter or in any other way an advertisement of any sort regarding merchandise securities service or anything so offered to the public which advertisement contains any assertion representation or statement of fact which is untrue deceptive or misleading shall be guilty of a misdemeanor

The following twenty five states have adopted it

Alabama	Michigan	Ohio
Colorado	Minnesota	Oklahoma
Idaho	Missouri	Oregon
Illinois	Nebraska	Rhode Island
Indiana	Nevada	Virginia
Iowa	New Jersey	Washington
Kansas	New York	Wisconsin
Kentucky	North Dakota	Wyoming
Louisiana		

The following thirteen states have substitutes patterned after the *Printers' Ink Model Statute* but in the opinion of critics, the statutes in these states are relatively ineffective compared with the original model

Arizona	Pennsylvania
California	South Carolina
Connecticut	South Dakota
Maryland	Tennessee
Massachusetts	Utah
Montana	West Virginia
North Carolina	

State and Local Control of Wages and Hours Anyone engaged in business should become familiar with state and local regulations affecting wages and hours. In some states there are special regulations as to the number of hours that may be worked, the opening time, and the closing time

of businesses. There is special control over certain hazardous industries as well as over the wages and hours of children and of women. Many of these laws give particular attention not only to the number of hours that children and women work but also to the particular hours in which they work during the day. They are forbidden in some instances to work overtime and are prohibited entirely from working in certain industries and types of businesses. There is, however, no uniformity in these state laws.

Federal Control of Wages and Hours The so-called Fair Labor Standards Act was enacted by the Federal Government in 1938. It is often referred to as the Wage Hour Law or the Fair Labor Law. The provisions of this Act cover only workers employed in industries that are engaged in interstate commerce or in the manufacture of goods shipped in interstate commerce. It does not attempt to regulate the wages and hours of executives, administrators, employees engaged in the professions, outside salesmen, or employees in retail and service establishments that conduct their business largely within the boundaries of a state. It also largely exempts agricultural workers and those engaged in the canning or packing of agricultural products. There are also a few other minor exemptions.

After October 24, 1940, the maximum number of hours that can be worked during a week is 40. Overtime is permitted provided employees are paid one and one half times their regular rate. An employer may arrange rates for overtime with his employees, provided he receives the sanction of the National Labor Relations Board. No employee is permitted to work more than 1,000 hours in any 26 consecutive weeks or more than 2,000 hours in any 52 consecutive weeks. Under all circumstances, however, work in excess of 12 hours a day or 56 hours a week must be compensated for at the rate of one and one half times the normal rate. Transportation employees are exempt because they are governed by the Interstate Commerce Commission. Certain seasonal industries, particularly those engaged in the production or the handling of perishable food

products are permitted to work their employees as much as 12 hours a day or 56 hours a week for not more than 14 weeks in any calendar year

The minimum wage rate is 30 cents an hour or the rate fixed by the administrator After October 24 1945 the rate is 40 cents an hour unless proof can be shown that this rate will curtail employment The administrator is charged with the responsibility of raising these rates as rapidly as he can

No producer manufacturer or dealer can ship or deliver in interstate commerce goods produced in establishments where oppressive child labor conditions exist Oppressive child labor conditions are constituted to be the employment of children under sixteen and the employment of children between the ages of sixteen and eighteen in occupations found hazardous by the Federal Children's Bureau Children may work for their parents in any occupations except manufacturing or mining Children under sixteen years of age who are not legally required to attend school may work in agricultural employment The Act exempts children employed as actors Children between fourteen and sixteen years of age may be granted permits for work in occupations other than manufacturing and mining if the Federal Children's Bureau finds that such employment will not impair the health or the well being of the child.

Control of Working Conditions Nearly every state and many cities have laws governing the sanitary and healthful conditions under which employees work Anyone going into business should investigate thoroughly the laws on this subject In most states these laws are administered under the state industrial commission. The local ordinances are administered by local inspectors or by the police

State laws usually govern such items as ventilation lighting sanitary conditions and safety precautions There are detailed regulations covering certain hazardous industries For instance special precautions must be taken in industries in which a person may be subject to lead poisoning or to some other industrial ailment

SELF-CHECKING STUDY QUESTIONS

(Chapter XI, Section 1)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer, reread the chapter until you find the correct answer; then compare your answers with those on pages 300 and 301 of this book.

True-False Questions

Directions: After each statement below that is true, draw a line under "true." After each statement that is false, draw a line under "false." The first statement is given as a sample.

0. The "willing-to-certify" list is a list based upon guaranteeing quantity true false
1. Various rights to property are constantly being modified true false
2. A private company may establish a mail service. true false
3. It is possible to copyright abstract ideas true false
4. There is a decreasing amount of regulation of business enterprises by the government true false
5. The early commerce of the United States was operated on a *laissez faire* basis true false
6. Business today operates fundamentally on a competitive basis true false
7. In recent years there has been considerable legislation by states to encourage the flow of commerce among the states true false
8. Monopolies are always undesirable true false
9. The Federal Government does not permit monopolies true false
10. The Interstate Commerce Commission determines the freight rates for goods being shipped from Chicago to New York true false
11. Fair trade laws permit price agreements between manufacturers true false
12. Small independent businessmen usually favor the Tydings Miller Act true false
13. The National Bureau of Standards publishes a list of "willing to certify" manufacturers true false
14. There is a high degree of uniformity in the wage and hour laws of the various states true false
15. Nearly every state and many cities have laws governing the working conditions of employees.. true false

Multiple-Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement The first is given as a sample

- 0 The *Printers Ink* Model Statute pertains to (a) dishonest advertising (b) grade labeling (c) copyrighting (a)
- 16 The right of a city government to take land for the widening of a street is known as (a) franchise (b) eminent domain (c) laissez faire ()
- 17 A contract that permits a person to use public property for private profit is a (a) copyright (b) patent (c) franchise ()
- 18 A tax charged when goods are bought in one state and used in another is an example of (a) chain store tax (b) use tax (c) income tax ()
- 19 The law that makes it possible for the owner of trade marked merchandise to specify the prices at which the various distributors such as wholesalers and retailers are to resell the merchandise is the (a) Robinson Patman Act (b) Tydings Miller Act (c) Sherman Antitrust Act ()
- 20 The proportion of goods bought by the consumer that is affected by the fair trade laws is (a) small (b) large (c) about one half ()
- 21 The designation of grading standards for canned goods is a right of (a) U S Department of Agriculture (b) National Bureau of Standards (c) U S Department of Commerce ()
- 22 The Food Drug and Cosmetic Act applies to (a) any drug sold in interstate commerce (b) any drug produced and sold within the same state (c) poisonous drugs only ()
- 23 The administration of the Federal fair trade laws is the responsibility of (a) U S Department of Commerce (b) Federal Trade Commission (c) Interstate Commerce Commission ()
- 24 A complaint of an unfair trade practice should be made to (a) the Secretary of the Treasury (b) the United States Department of Commerce (c) the Federal Trade Commission ()
- 25 The approximate number of states which have adopted the *Printers Ink* Model Statute is (a) fifteen (b) twenty five (c) forty ()

Section II

Taxation of Business

Social Security Taxation. The Social Security Act, which was passed on August 14, 1935, levies certain taxes on employers and employees for the purpose of providing funds from which payments can be made (a) to employees in the form of old-age benefits and (b) to employees as remuneration during periods of unemployment. There are two kinds of social security taxes; namely, those for old-age insurance, or benefits, and those for unemployment compensation.

Old-Age Insurance Taxes. The Social Security Act levied a tax on employers and one on employees. These taxes, which began on January 1, 1937, are paid into a fund of the United States Treasury. Benefits are paid from this fund to properly qualified individuals. Those eligible are explained on page 245.

Under this part of the law an employer is a person who employs one or more individuals. Not all employers, however, are governed by this law. For instance, the law exempts employers of farm labor, domestic help, and school teachers, as well as employers in certain other classifications, which may change from year to year in accordance with amendments to the law. In a sole proprietorship form of business the owner is not considered an employee. In a partnership form of business the partners are not considered employees. In a corporation the officers are considered employees. A director of a corporation is not an employee unless he performs services for the corporation other than the service rendered by attending and participating in the board meetings.

The tax on employers for old-age insurance is called the *employer's excise tax*. This tax is levied on the first \$3,000 of wages paid each employee during a calendar year, provided the business comes under the requirements of the Social Security Act. The rate of tax until January 1, 1945, is 1 per cent. This rate, however, is subject to change by

an act of Congress. If an individual earns \$4 000 in wages during a year and the rate of tax is 1 per cent, the employer's excise tax is \$30, or 1 per cent of the first \$3 000 in wages. Similarly, if an individual receives \$2 400 in wages, the employer's excise tax is \$24.

The tax on employees for old age insurance is called the *income tax on employees*. The rate of tax on employees is the same as the rate of excise tax on employers. In other words, an individual making \$4 000 a year pays a tax of \$30 at the 1 per cent rate and actually receives \$3 970. An individual making \$2 400 a year pays a tax of \$24 and actually receives \$2 376. This tax on the employee is similar to a premium that one might pay on an insurance policy for the employee expects to receive monthly benefits in later life as a result of the deductions made from his salary.

The law requires that the employer deduct the employee's income tax in paying the wages of the employee. As soon as wages have been paid, the employer is liable to the Federal Government for the amounts deducted from the wages of his employees. The amount deducted from the employee's wages is payable to the Federal Government by the end of the month following each calendar quarter. The employer's excise tax for the quarter is payable at the same time.

Old Age Benefits, or Insurance. An individual who has met certain requirements under the Social Security Act, including payments of the proper amounts as his employee's income tax, is eligible for monthly primary benefits after reaching the age of sixty-five years. These benefits are similar to the annuity payments that an individual would receive under an annuity insurance policy. The benefits are paid monthly until the individual dies. In other words, the taxes on the employee and on the employer for old age insurance build up a fund from which are paid to qualified individuals a monthly benefit after such individuals retire from active employment.

In addition to the monthly primary (old age) benefits paid to a qualified individual, the Act also makes provision for the following monthly benefit payments: wife's insur-

ance benefits, child's insurance benefits, widow's insurance benefits, and parents' insurance benefits.

Unemployment Compensation Taxes. Under this part of the Social Security Act, an excise tax is levied on the salaries of employees in businesses that have eight or more individuals. Certain types of businesses and employment are exempt from this tax. The excise tax is 3 per cent of employees' salaries, up to and including \$3 000 for each employee. The tax for the current calendar year is payable to the Federal Government by the end of January of the next year.

In addition to the Federal tax for unemployment compensation, each state has passed an unemployment compensation law under which employers are taxed on wages paid. In some states the taxes are called contributions instead of taxes. The basic rate of tax in most states is 2.7 per cent of the wages paid. The amount of wages on which the state tax is imposed varies in different states.

In paying the Federal tax of 3 per cent each year, employers are permitted to claim a credit up to 90 per cent of the Federal tax because of payments made to state governments for unemployment compensation. For example, if a particular employer has a Federal excise tax amounting to \$3 000 but has paid state unemployment compensation taxes on \$2,700, he may deduct the entire latter amount from the tax due the Federal Government and therefore pay the Federal Government only \$300. If he has paid state taxes of \$3,200, he is allowed a credit of only \$2 700, or 90 per cent of the \$3 000. Actually, the Federal tax in most cases amounts to only one tenth of 3 per cent, or 0.3 per cent. In most states the employer will pay a Federal tax of 0.3 per cent and a state tax amounting to approximately 2.7 per cent, or a total tax of 3 per cent.

From the amounts paid in Federal unemployment taxes, Congress appropriates each year to each state an amount to take care of administrative costs to operate the state unemployment plans. Benefits to unemployed workers are paid from the state funds.

The laws of the various states differ as to the methods of qualifying for unemployment benefits. In most states, however, if an employee becomes unemployed, he must wait a certain length of time before filing an application for unemployment compensation. There is also a limit to the length of time during which the employee can receive unemployment compensation. Because of the variations in the state unemployment compensation laws, it is not possible in this textbook to give detailed information as to the benefits paid for unemployment and the rates of taxes imposed. In a few states a tax, or contribution, is required of the employee as well as the employer.

ishments that may particularly affect the health of the community. In most states and in many cities there are special licensing laws that regulate the sale of such items as liquor and tobacco. Under a licensing system, inspectors are required for administering the law, and revenue is provided for the support of the government. Under the system a license may be revoked if the business is not operated according to the standards specified in the law. In order to start a business that must be operated under a license one must file an application in accordance with the law.

The control of itinerant peddlers has always been a problem because in the past many of these peddlers have been able to come into a community without paying taxes and without the normal control that is exercised over an established business. Many communities, however, have established the practice of licensing all peddlers.

Several states have enacted chain store licensing taxes. Most of this legislation is promoted by individuals who are opposed to chain stores. The tax is graduated in most cases. The rate, for instance, in one state starts at \$3 for the first store and runs to as high as \$300 a store. Usually the tax that is charged depends upon the number of stores within the state.

Sales Tax. The sales tax has become quite prominent in recent years. There is now a sales tax in almost every state. Although there is no uniformity in the administration of these taxes, in nearly every case the retailer is responsible for the collection of the tax and in turn must pay this tax to the state government. It is therefore important for the businessman to be familiar with the sales tax law of his state so that he can be sure to collect the tax properly and to keep records that will enable him to report the tax correctly.

Property Tax. In every state there is some form of property tax, and in some states there are two or more property taxes. For instance, there may be a real property tax, a personal property tax, and an intangible property tax. A real property tax is a tax levied on land and buildings.

A personal property tax is a tax on such items as furniture and fixtures. An intangible property tax is a tax on assets such as money in the bank, notes, stocks, bonds, and other securities. The businessman should familiarize himself with all the tax laws of his state to be sure that he gets the proper forms at the right time and reports his taxes accurately. If he is delinquent in paying his taxes or attempts to avoid the payment of them, he will be subject to a penalty.

A tax on property, whether on real, personal, or intangible property, is stated in terms of a percentage, of mills, or of dollars a thousand. It is most frequently quoted in terms of mills. For instance, a tax of 14 mills is \$14.00 a thousand or, on a percentage basis, .014. At this rate the tax on \$2,000 would be \$28.00.

Income Tax. A Federal income tax is imposed upon all individuals and business establishments. Different forms are provided for the individual, the sole proprietorship business, the partnership, and the corporation. Accurate bookkeeping records are required in order that the true income can be reported and the tax computed accurately. The income tax return gives instructions and provides a detailed form for reporting the various information that is required. Bookkeeping records of the type needed in preparing an income-tax return for a business are discussed and illustrated in Chapter VIII.

Withholding Tax. The Federal Government has imposed on the employer the responsibility for helping to collect the income tax of individuals. This tax is referred to as a withholding tax because the employer must withhold a prescribed amount from the pay of each employee. This money must be remitted monthly to any bank which is serving as a Federal depository. This function places upon the employer additional duties along with the other tax collecting duties. Special records are needed for the withholding tax because the employer is required to furnish the employee information as to the amount of the tax withheld.

Taxes as State Barriers. Theoretically, under the Constitution of the United States the Federal Government reserves the right to regulate commerce between the states. States may impose their own taxes but in recent years there has been a tendency to develop special state taxation laws that constitute barriers to interstate business. Illustration No. 87 shows various state taxes that tend to regulate commerce but serve as state barriers of business.

Variety of Taxes. Taxation has become so complicated that the average businessman spends a great deal of time in filling out tax forms in computing taxes and in making various reports. In many businesses the various taxes take a great percentage of the income. The following are examples of the types of taxes that a business operating in only one state might be required to pay:

- Federal income tax
- State income tax
- License fee
- Personal property tax
- Occupational tax
- Corporation tax
- Capital stock tax
- Federal social security (or excise) taxes
- State unemployment tax
- State industrial insurance tax
- Sales tax
- Use tax
- Gasoline tax
- Motor vehicle license

Furthermore a corporation doing business in several states will be subjected to numerous additional taxes some of which may be overlapping. If a business is organized in one state it probably will have to obtain a special license to do business in another state and will be subjected to the various taxes enforced in both states.

Government Services. The taxes that are collected from business and from individuals pay for the numerous services that are rendered to business and to individuals. The following are examples of those services:

- | | |
|---|------------|
| 5 The employer is required to deduct the employee's tax for the old age insurance fund from the wages of the employee and then remit it to the Federal Government | true false |
| 6 The widow of an employee who has been properly qualified may receive insurance benefits under the Social Security Act | true false |
| 7 Benefits to unemployed workers are paid from state funds instead of from the Federal Government | true false |
| 8 In large cities it is usually unnecessary to obtain a license in order to operate a restaurant | true false |
| 9 Many states have enacted chain store licensing taxes | true false |
| 10 Nearly every state has a sales tax | true false |

Multiple-Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement. The first is given as a sample

- | | |
|--|-------|
| 0 Under the Federal income tax withholding plan (a) the employer pays the tax (b) the employer withholds the tax and remits to the government (c) both the employer and the employee pay the tax | (b) |
| 11 To provide funds for employee benefits the Social Security Act levies taxes on (a) employees only (b) employers only (c) both employees and employers | () |
| 12 The Social Security Act provides benefits to employees for (a) old age benefits only (b) unemployment benefits only (c) both old age and unemployment benefits | () |
| 13 The employer is required to remit to the Federal Government the employer's excise tax (a) monthly (b) quarterly (c) annually | () |
| 14 The individual who has met the proper requirements under the Social Security Act is eligible for benefits after reaching the age of (a) sixty years (b) sixty five years (c) seventy years | () |
| 15 A tax on the furniture and fixtures of a grocery store would be (a) a real property tax (b) a personal property tax (c) an intangible property tax | () |

PRACTICAL PROBLEMS

(Chapter XI)

Complete the following problems. If you are doubtful about decisions reread the chapter. After you have completed the exercises you will find suggested solutions on page 308 of this book. If your answers do not follow the suggested solutions re-study your text then write your answers again.

- 11A Assume that the wages paid the employees of a business amount to \$17 256.50 during the year and no wage paid to any single individual exceeds \$3 000. (a) How is the Federal old age insurance tax computed? (b) How much does the employer owe the Federal Government for unemployment compensation taxes (excise taxes)? (c) How much credit does the employer get if he has already paid a state unemployment tax of \$517.70?
- 11B Compute the tax on real estate appraised at \$7 560 assuming that the tax rate is 21.4 mills.
- 11C Assume that a real-estate tax is assessed at the rate of 17 mills per dollar of valuation. (a) What is the tax per thousand dollars of valuation? (b) What is the tax on real estate valued at \$15 422.50?

CHAPTER XII

LEGAL RELATIONS IN BUSINESS

Purpose of the Chapter. There are certain legal problems which are of particular importance to anyone contemplating going into business. It should not be assumed, however, that a study of this chapter will provide a complete knowledge of business law. The following are some of the important questions that are answered in this chapter:

- 1 What is a contract?
- 2 What are the essentials of a contract?
- 3 What are the duties and obligations when property is entrusted to others?
- 4 What are the legal responsibilities of employers and employees?

Section 1

Contracts

What Is a Contract? A contract is an agreement, but not all agreements are contracts. For an agreement to be a contract, it must be the type of agreement that, if broken, will permit the injured person to obtain some remedy through law. The first essential of a contract therefore is an agreement. In nontechnical language, the other essentials of a contract are (a) that the consent of each party must be genuine and the agreement must be reached without threat or intimidation, (b) that the parties to the contract must be competent to enter into contracts, (c) that the purpose for which the contract is made must be legal, (d) that each party to the contract must offer or give something as a consideration (an exchange of values or benefits), and (e) that the contract must be in the required form.

Offer and Acceptance. Whenever an offer has been made by one person and accepted by another, an agreement has been reached, provided the offer and the acceptance have been made in accordance with certain legal regulations. Unless a specific date is mentioned when an offer is to be withdrawn or otherwise terminated, the offer may be accepted within a reasonable length of time. What may be considered a reasonable time will depend upon the circumstances.

Oral Contracts Versus Written Contracts. For the sake of certainty and safety, all important contracts should be written. Many contracts do not need to be written, for the entire transaction is executed at the time the contract is made. Those that must be written usually pertain to real estate. In some states any contracts that require more than a year for fulfillment must be written.

In some states a contract for the sale of merchandise above a specified minimum sum must be written. Sales contracts need not be in writing when the price is less than the amount designated in the law. As a rule, the minimum amount is \$500, but in some states it may be as low as \$50. It varies greatly in different states, ranging from \$30 to \$2,500. The Uniform Sales Act prescribes a minimum of \$500. In some states a sales contract must be signed by both parties, but in most states the contract or memorandum need be signed only by the party to be held to the contract. For instance, in some cases the buyer may wish to hold the seller, and in other cases the seller may wish to hold the buyer. Both the buyer and the seller should, of course, sign in order that each may have protection.

Importance of Reading Contracts. Some contracts are printed in very small type in the hope that they will not be read. The type, in fact, is so small in some contracts that it can hardly be read. Many old forms of contracts are printed in this manner, although the businesses that use them are entirely honest. A person should insist on reading a contract even if it is printed in small type.

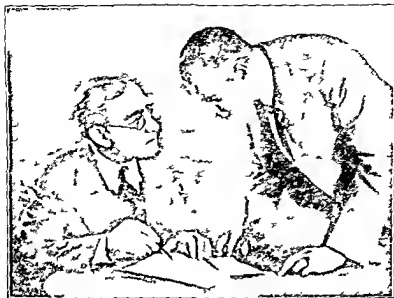


Illustration No 88 Read Before You Sign

Every contract should be examined carefully before it is signed. An honest and legitimate business will encourage the buyer to read the contract before signing whereas an unscrupulous business may try to induce the buyer to sign before reading. An invitation to read a contract should always be accepted. The document may be presented in the hope that it will not be read. If there is any indication that an attempt is being made to prevent the reading of the contract one should insist upon reading every detail.

Reasons for Written Contracts In a casual oral agreement there may be some misunderstanding as to price terms of sale or other elements of the contract. The mere writing of a contract should cause each party to give more careful attention to the details than he could in the case of an oral agreement.

In an oral contract there may be an apparent agreement but if the contract is to be fulfilled later some of the terms of the agreement such as the quantity of the product to

A simple signed order for merchandise or for any other item is a contract. For instance, when one signs an order for the purchase of an automobile, he is signing a contract. Illustration No. 90 shows a memorandum of an agreement leading to the sale of equipment on an installment plan. When this memorandum is properly filled out and signed, it becomes a contract. This type of contract must be in writing.

Bill of Sale. Bills of sale are used in selling many types of merchandise. In most states, but not all, a bill of sale is required to provide evidence of ownership. For instance, it is impossible in some states to obtain an automobile license without providing a bill of sale or a sworn statement as evidence of the ownership of the automobile. If the bill of sale has been lost, it is possible to establish the ownership by going through the legal procedure of obtaining a sworn statement of ownership. The most common type of bill of sale is that used in selling automobiles. In many states, bills of sale of different types are required for new cars and used cars. Illustration No. 91 shows a typical bill of sale for a new car.

In most states in which a bill of sale is required, the transaction is not completed and legal until the contract has been recorded by the local recorder or other designated public official. The recording of a bill of sale prevents an unscrupulous seller from selling the same merchandise again to another buyer who has no knowledge that the merchandise has already been sold.

Uniform Sales Laws. The Uniform Sales Act has been adopted by almost every state. The purpose of the Uniform Sales Act is to establish some uniformity in the provisions of the sales laws in the various states. When transactions take place between businessmen located in different states, many complications arise with regard to the contracts because of differences in the requirements and in the interpretations of the sales laws in those states.

The uniform sales laws are quite technical. When there is some question about a contract or there is a possible

lack of uniformity between one state and another, the businessman should consult a lawyer

Warranties The seller's statements of opinion or belief as to the value or the merit of an article, as well as the commendations used to induce a purchase are not warranties. In the eyes of the law certain statements of a seller are *puffs*. For instance, a seller may assert that certain merchandise is "the best that can be obtained" or that a particular machine is "a thoroughly dependable machine." Such statements should be considered not as warranties, but as *puffs* or *trade talk*, and should not be relied upon by the buyer.

A warranty is a statement or an implied affirmation of fact (not opinion) that the subject of a contract is as it is declared or promised to be. For example, if an oral or a printed statement with regard to a product declares that the product "will not damage silks" such a statement is a warranty. In the absence of fraud and of any special regulatory law the principle of "Let the buyer beware" is followed. It is assumed that, if a person inspects an article before buying it and if he is not misled by fraud, he should know what he is getting.

When a buyer has an opportunity to inspect the goods there is no implied warranty that the goods are of a particular quality. If the buyer does not inspect the goods however, but relies largely on the judgment and the honesty of the seller, there is an implied warranty (on the part of the seller) that the goods are of a satisfactory quality. The goods therefore must be suitable for the purpose for which they are sold.

When a sample is used to indicate the kind and the quality of the goods, the seller impliedly warrants the goods to correspond to the sample in kind and quality.

When merchandise is purchased by description, such as specifications the seller impliedly warrants the goods to correspond to the description. (See Illustration No 92.)

Remedies for Breach of Warranty. There are various remedies in case of a breach of warranty. The following

general recourses are open to the buyer: (1) to keep the goods and to deduct from the price the amount of the damages (2) to keep the goods and to bring an action against the seller for damages, (3) to refuse to accept the goods and to bring an action against the seller to recover damages, (4) to rescind the contract and to refuse to receive the goods, or, if the goods have been accepted, to return them to the vendor and to recover the price that has been paid.

Passing of the Title. Two general rules govern the passing of the title when goods are sold although there are exceptions in some states, especially with regard to such other goods as coal, wheat, or oil, of which any unit is considered to be the equivalent of any other unit. The two rules determining the passing of the title are (1) under a contract to sell *unascertained goods*, the title will not pass until the goods have been ascertained, (2) under a contract to sell *ascertained goods*, the title passes at the time the parties intend it to be transferred.

Unascertained goods are goods included in a lot of merchandise of the same general kind and are consequently not distinguishable until an actual selection has been made. When the specific goods have been selected they are said to be ascertained.

For instance Mr A had agreed to sell Mr B one hundred women's dresses at a specified price the dresses to be selected by Mr B from a display in Mr A's exhibit rooms. Mr B delayed the selection of the dresses, although he was urged to make his selection by Mr A. In the mean time there was a fire in the exhibit rooms of Mr A. The fire destroyed about four hundred of the two thousand dresses on display. Mr A contended that Mr B should pay the loss on the dresses that the latter had contracted to purchase. The contention was that the dresses had been available for Mr B to make a selection and that, if he had made his selection on schedule Mr A would not have to bear the loss on those dresses. In this case however, the title to the dresses had not passed to Mr B because the goods had not been ascertained. Mr B was therefore not responsible for any loss.

On the other hand if Mr B had selected his dresses and had agreed to call for them the goods would have been ascertained and the title would have passed to Mr B. In such a case the court would probably decide that Mr B must be responsible for the loss of the dresses that he had purchased.

When goods are sold f o b the shipping point, the buyer is required to pay the transportation charges, and the title ordinarily passes to the buyer at the time the shipment is turned over to the transportation company. If the goods have been sold on open account the title does pass to the buyer at this time but if they are sent C O D or if they are to be turned over to the buyer when a draft is signed or when some other condition is fulfilled the title does not pass to the buyer until that condition has been fulfilled. When goods are shipped f o b destination the seller pays the transportation charges. Under such a condition the title ordinarily passes to the buyer at the time the goods

are delivered to the buyer by the transportation company, but, as in the preceding example, the title may not pass to the buyer until the goods have been paid for or some other condition has been fulfilled.

Place and Time of Delivery. When the place of delivery of goods is not specified, it may be the seller's place of business or it may be fixed by the custom of the trade. For instance, when products are to be delivered for sale through a commission house, the custom of the trade may require them to be delivered at a certain warehouse or placed on a railroad siding for examination. The place of delivery of steel shipped on barges may be the waterfront of the city to which the steel is being delivered.

If no time is set for delivery, the vendor must make delivery within a reasonable time.

Acceptance. The buyer is under a duty to accept and pay for the goods, provided delivery of them is made in accordance with the terms of the contract. The acceptance of the goods is indicated by (a) a specific indication that the buyer accepts the goods, (b) the use of the goods, or (c) the retention of the goods for an unreasonable length of time.

Unenforceable Agreements. In the absence of any disqualifying factors such as those indicated below, an exchange of assents constitutes an enforceable agreement, provided the assents are genuine. An agreement is not enforceable under any of the following circumstances:

- 1 If there is a mutual *mistake* as to the identity of the subject matter. For example, assume that Mr. French offers to sell Mr. Thomas a team of horses. Mr. French has two teams of horses of the same general color and description. He has reference to a particular team that he is willing to sell, but Mr. Thomas has the other team in mind when he accepts the offer. There is a mutual mistake as to the identity of the subject matter.

- 2 If fraud in the form of intentional misrepresentation is present. Consider the following example Mr Allen intentionally misrepresents to Mr Smith that he is acting as an agent for a certain producer of clothing When the merchandise is delivered Mr Smith discovers that Mr Allen is acting as the agent for an entirely different producer Mr Allen is guilty of fraudulent representation
- 3 If one person makes an agreement as the result of a threat or an act of violence For instance Mr A induces Mr B to sign a contract for merchandise under a threat that Mr B's daughter will be abducted if he does not sign the contract This contract is not enforceable for it has been obtained by means of a threat of violence
- 4 If there has been undue influence to the extent that one person has not reached the agreement through the free exercise of his own judgment For instance consider the case of an aged woman who has inherited a small sum of money She is besieged by several representatives of a furniture company who after prolonged high pressure selling induce her to spend a large portion of her inheritance for furniture Such a case probably represents undue influence

Protection of the Seller In case the buyer of merchandise fails to perform his part of the contract, the seller may sue for payment if the title has passed sue for damages if the title has not passed or rescind the contract At any time the buyer and the seller may rescind the contract by mutual agreement but the seller may rescind the contract if the buyer fails to perform his part of the contract If the seller contemplates taking any legal action he should however, consult a lawyer

Protection of the Buyer In case the seller fails to perform his obligation the buyer may recover the goods or the value of the goods if the title has passed If the title has not passed, he may sue for damages or, if he choose

rescind the contract. If he desires to do so, he may insist upon the fulfillment of the contract. Before any legal action is taken, the buyer should always consult a lawyer.

Voidable Contracts A *voidable contract* is an agreement that may be enforceable but, because of the lack of an essential of contracts, may be made inoperative by one or both of the parties.

All contracts made by persons with unbalanced minds are voidable. A contract of this type may be rescinded by the guardian of the person with the unbalanced mind.

A minor (an individual who has not attained legal age) can void all his contracts except those for necessary things such as food and clothing. Even in the case of necessities, however, the minor is responsible for only a reasonable amount. The fundamental reason for permitting minors to rescind their contracts is that they need certain protection from unscrupulous persons.

Consider the following example. A youth of twenty bought an automobile. When he became of age, he returned the automobile and demanded his money. He was entitled to his money, for he had entered into the contract when he was a minor. As he disaffirmed the contract soon after he had reached his majority, he voided it. If he had failed to disaffirm the contract within a reasonable time after reaching his majority, he could not have avoided the contract.

Suppose the youth mentioned in the preceding example had agreed, while twenty years of age, to buy an automobile when he became twenty-one years of age. In this case the contract would not have been executed until after he became of age. He would therefore not have been liable unless he had ratified the contract after reaching his majority.

All contracts made with intoxicated persons are voidable. A contract made with such a person may be rescinded by that person when he becomes sober.

SELF-CHECKING STUDY QUESTIONS

(Chapter XII, Section I)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer reread the chapter until you find the correct answer then compare your answers with those on page 301 of this book. Refer to the printed answers only after you have made a serious effort to answer all questions for otherwise the questions will not be of greatest value to you. If you have any incorrect answers reread the part of the chapter in which those questions are discussed.

Completion Questions

Directions Write one word in each blank space in each statement given below to make the statement complete and accurate. The first is given as a sample.

- 0 The first essential of a contract is an agreement.
- 1 An agreement which if broken will permit the injured person to obtain some remedy through law is called a _____.
- 2 An agreement that may be enforceable but because of the lack of an essential of a contract may be made inoperative by one or both of the parties is a _____ contract.
- 3 A seller's statements of opinion or belief are not warranties but are called trade talk or _____.
- 4 A statement or an implied affirmation of fact that the subject of a contract is as it is declared or promised to be is a _____.
- 5 If no time is set for the delivery of goods the vendor must make delivery within a _____ time.

True-False Questions

Directions After each statement below that is true draw a line under true. After each statement that is false draw a line under false. The first statement is given as a sample.

- 0 Parties to a contract must be competent true false
- 6 Contracts obtained under threat or intimidation are valid true false
- 7 A contract made with an intoxicated person is enforceable true false
- 8 If the buyer of merchandise fails to perform his part of the contract the seller may sue for payment if the title has passed true false

- 9 The seller may rescind the contract if the buyer fails to perform his part of the contract true false
- 10 A buyer of a cash register has the right to return it any time before he pays for it true false
- 11 If the seller fails to fulfill his part of the contract and title has not passed the buyer may rescind the contract true false
- 12 If the seller fails to perform his obligation under a contract the buyer may insist upon fulfillment of the contract true false
- 13 When goods are sold f o b the shipping point, the title ordinarily passes to the buyer at the time the shipment is delivered at its destination true false
- 14 If there has been a breach of warranty the buyer may keep the goods and bring an action against the seller for damages true false
- 15 When goods are sold by samples the seller impliedly warrants that the goods delivered will correspond to the sample in kind and quality true false

Multiple Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement. The first is given as a sample

- 0 For a contract to be legal and binding the purpose must be (a) to sell goods (b) legal (c) for the benefit of one party (b)
- 16 If a person has not reached an agreement through the free exercise of his judgment the contract is unenforceable because of (a) undue influence (b) lack of understanding (c) misrepresentation ()
- 17 If A sells B some clothes made of part wool which were described as all wool the contract is unenforceable because of (a) misrepresentation (b) mutual mistake (c) intimidation ()
- 18 Acceptance of goods may be indicated by (a) acknowledgment that the goods have been received (b) opening the package (c) use of the goods ()
- 19 A contract is unenforceable if there has been (a) fraudulent misrepresentation (b) use of the goods (c) acceptance of the goods ()
- 20 Under a contract to sell ascertained goods the title passes at the time (a) the goods have been ascertained (b) the parties intend it to be transferred (c) the goods are examined ()

Section II

Bailments and Shipping

What Is a Bailment? Every businessman at some time has property entrusted to him that belongs to someone else. Some of his property will also be entrusted to others. The relationship which exists when there has been a transfer of possession of property without a change in ownership is called a *bailment*. Bailments apply only to personal property or goods, but never apply to real property such as a garage or a piece of land.

With the exception of the case of lost property, a bailment is the delivery of personal property by one party, generally the owner, to another for some particular purpose with the understanding that the identical property is to be returned when that purpose has been accomplished.

Parties to a Bailment. The one who owns or delivers the property is known as the *bailor*. The one to whom the property is delivered is known as the *bailee*. It will be noted that the bailor is the one who parts with the possession but not the ownership of the property, while the bailee is the one who receives the possession but not the ownership.

Common illustrations of bailments are a watch left with a jeweler to be repaired, a borrowed typewriter property left with another for safekeeping, an umbrella forgotten in a store, a package delivered to an express company or to a freight office for shipment, clothing left with a dyer and cleaner, or an automobile that has been rented.

Express or Implied Contract of Bailment. A bailment is based on a contract, either express or implied, between the bailor and the bailee. If the relation is the result of a definite agreement, it is an express contract, if it results from some act or gesture that implies that a bailment exists, it is an implied contract. When one enters into an agreement with another to store merchandise, there is an express contract. If one leaves merchandise on the platform of a ware-

house after requesting that it be placed in storage, the mere placing of the goods in storage is an implied acceptance of the contract.

Since one who finds lost property is under legal duty to return it to the rightful owner, he accepts the implied contract that obligates him when he takes possession of lost property

Types of Bailments. Bailments are classified in three distinct groups as follows: (a) for the sole benefit of the bailor, (b) for the sole benefit of the bailee; (c) for the mutual benefit of both parties

A *bailment for the sole benefit of the bailor* exists when a person requests another to take care of his property but does not give anything of value as compensation for the service. An example would be the turning over of a package to a store with the request that it be kept safely until it is called for. If it is accepted for safekeeping, the person accepting it is liable for the value if he is grossly negligent in taking care of it. If he uses proper care, he will not be liable for any loss.

A bailee who acts merely as a custodian of the property, or who is charged to do something to or with the property for the exclusive benefit of the bailor, has no right to use it for his own purpose. He may not use, give away, or treat the property as his own. He may, however, use the property if its use is beneficial to its preservation.

A *bailment for the sole benefit of the bailee* is illustrated by one who borrows an article but does not pay for its use or give something of value in return therefor. Let us assume that Mr. Jackson borrows an adding machine from Mr. White. In such a case, Mr. Jackson must take the greatest care of the machine. If it is lost, stolen, or damaged because of negligence, he will be liable to Mr. White. If he exercises extraordinary care and precaution, he will not be held legally liable for its loss, although he may consider himself morally liable.

If the bailment is for the benefit of the bailee, he has the right, of course, to use the property in accordance with the

terms of the contract. He is however strictly confined to the use agreed upon and if he uses the property in another way he will be liable for any resulting damages. He is not liable for inevitable accidents but he is liable for any damages that might have been prevented with due care.

A *bailment for the mutual benefit of both parties* is one in which both parties are presumed to be benefited. This is the most common type of bailment and is probably the most important in business. Such bailments are formed when goods are left with a mechanic for repair when goods are stored when property is pledged as security for a loan, and when goods are turned over to a transportation company for shipment. Mutual benefit bailments require only ordinary care on the part of the bailee. He is therefore held liable only for ordinary negligence. Ordinary care is considered to be the kind of care which the average individual usually exercises under ordinary conditions over his own property of a like or a similar kind.

If the bailment is for the mutual benefit of both parties, the wrongful use of the property does not make the bailment void, but it does make the bailee liable for any injuries caused by the wrongful use. In this case the bailee is not liable for inevitable accidents or the willful acts of third parties. He must use the property for the purpose stated in the agreement, and any deviation will render him liable for resulting damages.

A Bailee's Lien. When a bailment of mutual benefit exists the bailee has a specific lien on the subject matter of the bailment as a security for any amount owed the bailee. For instance, this right applies to storage charges or charges for other services. It also applies in the case of a mechanic who may have repaired or improved the property entrusted to him. To make this lien effective, the bailee must have possession of the property. If he surrenders possession before the payment has been made, he does not have the right of a lien.

Pledge, Pawn, Security. A pledge or a pawn is a deposit of personal property as *security* for some debt or obliga-

tion. Property such as livestock, radios, and automobiles, or intangible property such as notes, bonds, and certificates of stock (usually referred to as collateral securities), may be pledged.

The pledged or pawned property must be delivered in order that a pledge will be established. The one who delivers the property is known as the *pledgor* or the *pawner*; the one to whom delivery is made is called the *pledgee* or the *pawnee*. The pledgee or the pawnee has a right to the possession of the property until the debt has been paid in full or the obligation has been discharged.

Although all transfers of personal property as security are pledges, the term *pledge* is used to denote the transfer of intangible property, and the term *pawn* is used to denote the transfer of personal property other than intangible property. A pledge is a bailment for the mutual benefit of both parties. The pledgee is therefore under a duty to exercise ordinary care for the preservation and safekeeping of the pledged property. He must do so even after the owner has failed to meet his obligation when it was due.

A common practice of this nature that a person in a small business will encounter is the pledge of some kind of asset as security for a loan. One may, for instance, turn over to the bank some government bonds which the bank keeps as security for a loan. Warehouse receipts are also used for this purpose. For instance, one may have some merchandise stored in a warehouse and may turn the receipt for the merchandise over to a bank as a pledge for a loan.

In most states the pledgee has, upon the failure of the pledgor to make payment, the right to sell the property at a private sale and to apply the proceeds to the payment of the debt. In some states the legislature has prescribed the manner in which the sale must be made. The purpose of these statutes is to secure a fair sale of the property.

In the absence of an agreement, the pledgee may use his own judgment as to when he will exercise his right to sell the pledged property. This rule is true even though the bailor requests the bailee to sell the property. The remedy

of the pledgor is to redeem the pledged property. If the pledgor does not redeem the pledged property the bailee is not bound to sell it.

Termination of Bailments A contract of bailment may be discharged in the same manner and for the same reasons that other contracts are terminated. A bailment contract is no exception to the principles of law applicable to contracts in general. If the bailment cannot be performed according to its original purpose because of an unforeseen event unknown to the parties at the time the agreement was made the bailee is under an obligation to give the bailor reasonable notice of his intention to terminate the relationship in order that he may be relieved from further liability.

Common and Private Carriers Every businessman has occasion to use both common and private carriers. The term *common carrier* is generally applied to carriers engaged in the carrying of personal property or goods. These include railroads, trucking companies, express agencies, steamships and air transport companies. A common carrier must perform the same service for all persons without discrimination.

A *private carrier* is one which is not engaged in the public business of transportation but which undertakes for hire in special cases and under special arrangements to carry the goods of another to a particular place. He does not offer his services to anyone who desires them. He reserves the right to select his customers. Moving vans, ordinary truckmen, private delivery agencies and short railroads not doing a public business are examples of private carriers.

When property is entrusted to a carrier a bailment exists. Special rules and laws apply to carriers.

Duties and Rights of Common Carriers The carrier must furnish adequate service and must make uniform charges in accordance with the nature of the goods hauled and the distance moved. He is not, however, bound to carry goods

of every description, but only that class of goods which he usually transports in the course of his calling. Thus an express agency is not obliged to carry heavy freight shipments because its business is confined to small and valuable articles. An express agency would not be required to transport a carload of cattle nor would a railroad company be required to move a valuable shipment of diamonds.

A common carrier is bound to provide ample facilities for receiving freight for shipment and for protecting it after it has arrived at its destination and until it is delivered to the consignee. A carrier must furnish not only a reasonable number of cars but also cars that are suitable for the safe and efficient transportation of the goods. The carrier is under a duty to protect the goods from the elements and he must furnish ventilated cars if they are the only safe means of moving the goods. The carrier must also protect the goods from loss or injury while they are in transit. In the case of perishable goods he must provide refrigerator cars. If the contract calls for delivery at a specified time the carrier will be held accountable for failure to comply with that provision.

A common carrier is held to a strict accountability for any loss or damage occurring to the goods while they are in his possession whether the loss or damage is due to his negligence or not. The liability of the carrier begins when the goods are delivered by the shipper and received by the carrier. Within certain limitations a common carrier is held liable as an insurer of the property.

Common carriers may make reasonable rules and regulations for the operation of their business provided such rules apply alike to all persons. They may require goods to be crated for protection. They cannot be compelled to carry goods that are in violation of the law or that do not come within the class of goods that they usually carry. Carriers have a right to demand the payment of their charges in advance and if they do not exercise this right they have a lien on the goods for the charges. Such a lien may include charges necessarily incurred for storage or charges advanced to connecting carriers.

Duties and Rights of Private Carriers A private carrier is liable only for failure to use the skill and care that an ordinarily prudent person would exercise in the conduct of his business. Since the private carrier has the right to make special arrangements and contracts with his clients, he may restrict his liability to any degree, even to the extent of not being liable for his own negligence. A businessman in dealing with a private carrier must therefore recognize his arrangements with the private carrier and cover the carrier's responsibility.

Factors Limiting the Responsibility of Carriers In the absence of statutes or custom limiting the liability of the carrier he will be regarded as an insurer of the goods while they are in transit. He is not liable however, for any loss or damage caused by (a) an act of God (b) an act of a public enemy (c) the fault of the shipper, and (d) the inherent nature of the goods.

An act of God A cause of injury that human power cannot prevent nor human prudence avert is considered an act of God. Acts of God include unprecedented floods, earthquakes, tornadoes, lightning, and the like. Although the loss does arise from this or one of the other excepted causes, the carrier may be held liable if he or his agent is guilty of negligence.

An act of a public enemy By the phrase *public enemy* is meant an organized force with which the nation is at open war. Mobs, rioters, strikers, and highwaymen are not included in this class of public enemies. A carrier is liable for a loss that is caused by fire, water, robbery, or other accidental causes.

The fault of the shipper If a loss is due either to the improper packing, marking, or addressing of the goods, or to the failure of the shipper to inform the carrier of the nature of the goods, the carrier is excused from liability.

The inherent nature of the goods A loss is due to the inherent nature of the goods when it arises from the natural decay of fresh fruits, vegetables, or other perishable commodities, the evaporation or the fermentation of

liquids and the death or the injury of animals through their own fault or the fault of other animals. In the case of such a loss the carrier is released from liability.

Termination of Liability of a Carrier The liability of a common carrier ends when the goods are turned over to the consignee. If the carrier maintains a freight terminal or depot the consignee must call at that place for his property. The failure of the consignee to call within a reasonable time after having received notice of the arrival of the goods releases the carrier from liability as an insurer. He remains liable, however, as a warehouseman. A warehouseman is a bailee whose liability is the same as that of a bailee in an ordinary mutual benefit bailment.

Telephone and Telegraph Companies Telephone and telegraph companies are carriers of messages but they are not classified as common carriers. They are considered public utilities and are required to serve all persons alike for uniform and reasonable compensation. They are under the control of the Interstate Commerce Commission in matters pertaining to interstate business. They must use ordinary care in sending and delivering messages and will be held responsible for want of care or skill in the performance of their duties. They do not insure the safety and accuracy of messages but they will be held liable for ordinary negligence.

SELF-CHECKING STUDY QUESTIONS

(Chapter XII, Section II)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer reread the chapter until you find the correct answer then compare your answers with those on page 301 of this book. Refer to the printed answers only after you have made a serious effort to answer all questions. For other wise the questions will not be of greatest value to you. If you have any incorrect answers reread the part of the chapter in which those questions are discussed.

Completion Questions

Directions Write one word in each blank space in each statement given below to make the statement complete and accurate. The first is given as a sample.

- 0 The relationship which exists when there is a transfer of property without a change in ownership is a bailment.
- 1 A pledge or a pawn is a deposit of personal property as _____.
- 2 In a bailment, the one who owns or delivers the property to another is known as a _____.
- 3 In a bailment, the one to whom property is transferred or delivered is known as a _____.
4. When one borrows an article but does not pay for its use or give something of value in return, the relationship is a bailment for the sole benefit of a _____.
- 5 A bailment is an express or implied _____.
- 6 When property is pledged or pawned, the one who delivers the property is known as the pledgor or _____.
- 7 When property is pledged or pawned, the one to whom delivery is made is called the pledgee or the _____.
- 8 A public carrier such as a railroad which must perform services for all persons without discrimination, is called a _____ carrier.
- 9 A carrier not in the public business of transportation but which makes special contracts with its clients for the hauling of goods is called a _____ carrier.
- 10 A cause of injury that human power cannot prevent nor human prudence avert is considered an _____.

True-False Questions

Directions After each statement below that is true, draw a line under "true." After each statement that is false, draw a line under "false." The first statement is given as a sample.

- 0 One who finds lost property is a bailee true false
11. A bailment for the mutual benefit of both parties requires only ordinary care on the part of the bailee true false
- 12 A railway express company is a private carrier true false
- 13 A private carrier must accept for transportation without discrimination anything that it customarily hauls true false
- 14 Bonds are often pledged as security for the loan of money true false
15. A telegraph company is a common carrier true false

Multiple-Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement. The first is given as a sample

- 0 The bailment that exists when one person requests an other to take care of his property but does not give anything of value as compensation for the service is (a) for mutual benefit, (b) for sole benefit of bailor (c) for sole benefit of bailee (b)
- 16 If a railway express company is requested to haul a carload of cattle (a) it may refuse (b) it must haul the shipment (c) it may be sued if it refuses ()
- 17 If goods are damaged by strikers while in the possession of a common carrier the one who must stand the loss is (a) the carrier, (b) the government (c) the owner of the goods ()
18. The liability of a common carrier terminates (a) when the goods reach the carrier's own warehouse (b) when the goods are turned over to the consignee (c) when the consignee is notified of the arrival of the goods ()
- 19 A private carrier (a) has the same duties as a common carrier (b) has greater liability than a common carrier (c) may restrict its liability by special arrangement ()
- 20 If property has been pledged as security for a debt but the debt has not been paid according to agreement the pledgee (a) may sell the property (b) may return the property and sue for payment (c) must keep the property indefinitely ()

employee's contributory negligence. In other words, the employer may escape liability if he can prove that the employee was negligent

If an employer commits a wrongful act against the employee, such as striking the employee, the latter is entitled to recover damages

An employer is liable to third parties for the wrongful acts of his employees that he commands, tolerates, or ratifies. An employer is also liable to third parties for injuries caused by the negligent, wanton, or malicious acts of his employees while the employees were acting within the scope of their employment. The employer is not liable, however, if the acts were outside the authority of the employees. Some of the conditions to be considered in deciding whether an act was within the scope of the employment are (1) the nature of the work, (2) the employee's customary duties, and (3) the employer's approval or ratification of the act

Termination of Employment. When the relation of employer and employee is based upon a contract of employment, the relation may be terminated in the same manner as any other ordinary contract. When the relation exists for an indefinite period, either party may terminate the relation at any time by giving reasonable notice. In such a case the party terminating the relation will not incur any liability

Justifiable Discharge. An employer may discharge an employee for cause before the end of his term of employment. When an employee is thus discharged, he has no legal right of action against his employer for damages. In the event of a discharge of an employee without cause before the end of his term of employment, however, the employer is liable for damages. Justifiable causes for discharge may be summarized as follows

1. The willful disobedience of any reasonable and lawful order.
2. Gross moral misconduct, defrauding the employer, or revealing trade secrets

- 3 Incompetency, serious illness, or permanent disability
- 4 Habitual neglect in the performance of duties

Justifiable Abandonment. When an employee abandons (quits) his employment without cause before the end of his term of employment, he is liable for damages. There are certain circumstances, however, under which an employee may rightfully abandon his employment and not be held liable for a breach of contract. These causes may be summarized as follows:

- 1 The nonpayment of wages
- 2 The wrongful assault of the employee by the employer
- 3 The performance of services not contemplated in the agreement.
- 4 Injurious conditions of employment due to the negligence or the acts of the employer

Employee's Protection. Because of the fact that labor legislation is constantly changing, it is not possible to provide any accurate interpretation of Federal and state laws without some assumption that they will go out of date soon. However, most forms of employment are governed by both state and Federal laws which, to some extent, regulate conditions of work, hours of work, rates of pay, methods of compensation, child labor, female labor, hiring, and discharging. Federal and state laws relating to labor unions prescribe the contractual procedure between labor unions and employees.

In most states laws pertaining to some form of workmen's compensation are enforced. Workmen's compensation laws are those which provide compensation to employees for injury occurring in the performance of duties.

Before hiring his first employee, any businessman should familiarize himself with both the Federal and the state laws pertaining to employment.

Distinction Between Agents and Employees. The previous discussion in this section has dealt primarily with the relationship that exists between an employer and an

ordinary employee The term *employee* is generally used to refer to anyone working for an employer However, there are certain types of employees who are, from a legal point of view, considered to be *agents* of their employers Business as we know it could not be transacted by the owner without the assistance of others It is therefore through hired agents or special types of employees that they conduct their business

In the relation of employer and employee only two parties are concerned the employer and the employee An ordinary employee does not have the authority to bind his employer by contract with third parties However, such an employee may create a liability for his employer arising from negligence, trespass or assault An agent is hired for the purpose of creating contractual relationships with third parties

An example will serve to make the distinction clearer The owner of a store hires a manager who has authority to represent the employer in buying, selling and carrying on the functions of a business This person has the status of an agent The owner also hires a janitor If the janitor is an ordinary employee, he does not have any right to create contractual obligations for the owner However, if the owner should send him to a supply house to buy something for the business, the janitor would then become an agent, making a purchase in behalf of his employer Both the manager and the janitor could create liabilities for their employer through negligence, trespass, assault, or other crimes committed in the performance of duty

Definition of Agency. An *agent* is one who is employed and authorized to represent and to act for another, in a contractual capacity, in business dealings with third parties Therefore, an *agency* is a legal relation in which one person acts for and in the place of another

There are three parties concerned in an agency The one who grants the authority is the *principal*, the one to whom the power or authority is delegated is the *agent*, and the one with whom the business is transacted is known as the

third party The agent may be a person, a partnership or a corporation

What one may not lawfully do himself may not be done through another. Thus no person can authorize an agent to commit a crime, to publish a libel, to perpetrate a fraud, or to do any other act that is illegal, immoral or opposed to the welfare of society. An agreement to act as an agent to help another to make a sale through improper means or to defraud the public cannot be enforced.

Classifications of Agencies Generally speaking there are two classifications of agencies: (a) general agents and (b) special agents.

A *general agent* is one who is authorized to transact all the business for his employer at a particular place. A clerk who completely manages a store for the owner is an example of a general agent.

A *special agent* is one who is authorized by his employer to perform some specific act or acts or to transact certain specified business. For instance, an agent may be delegated to sell but not to buy. An agent may also be given the authority to buy a piece of real estate. Each of these would be a special agent.

Creation of Agencies Agencies may be created by (a) appointment, (b) ratification, (c) estoppel, and (d) necessity.

The most common way of employing an agent is by *appointment*. Agency is created by appointment when authority is definitely and specifically granted. The appointment may be written or oral and in many cases requires no specified process. However, many types of agencies of this kind require a formal written authority. As an example, a person who has full authority to manage a store for his employer could not sell the real estate without a formal written appointment as agent. The formal written instrument used for this purpose is called a *power of attorney*.

Agency may be created by *ratification*. An agency created by ratification is one in which the principal ratifies an act of an unauthorized agent. The agent may not have

had real or apparent authority or the act may have been performed by a real agent who exceeded his authority. For instance a clerk may have exceeded his authority by contracting to sell a delivery truck. If the employer approves the act after learning of it he is bound by the contract. However the employer is not bound by an act until he ratifies it.

The agency created by ratification should be distinguished from the agency created by *estoppel*. Agency by estoppel is created when by words or conduct of the principal a third party is led to believe that a person has authority to act as an agent. In the latter case the principal by implication allows himself to become bound. Let us assume that a young man working in a store signs an order while his boss is busy but with the knowledge of his boss. Gradually this practice becomes more prevalent and in the absence of the owner he makes purchases to the extent that persons dealing with the business assume that the young man has authority to enter into contracts. Generally speaking in such cases the owner will be bound by these contracts.

The relationship of agency may be created by *necessity* or *emergency*. The driver of a truck operated between distant cities may pledge the owner's credit in order to have needed repairs made so that the truck may proceed on its way.

Extent of Authority A principal is liable to a third person for all contracts entered into by the agent within the scope of the agent's authority and also for such acts of the agent as may be necessary in the performance of his duties. The authority of the agent consists of the authority conferred upon him by his principal and such implied powers as are reasonably necessary to carry out the purposes for which the agency was created. A principal is also liable for such acts of the agent as are within the apparent scope of the authority conferred upon the agent.

SELF-CHECKING STUDY QUESTIONS

(Chapter XII, Section III)

Fill in the answers to the following questions in the space provided after each question. Read carefully the instructions for each group of questions before writing your answers. If you are doubtful about an answer, reread the chapter until you find the correct answer, then compare your answers with those on page 301 of this book. Refer to the printed answers only after you have made a serious effort to answer all questions, for otherwise the questions will not be of greatest value to you. If you have any incorrect answers, reread the part of the chapter in which those questions are discussed.

Completion Questions

Directions Write one word in each blank space in each statement given below to make the statement complete and accurate. The first is given as a sample.

- 0 Persons who hire their services to other individuals, partnerships, or corporations are known as employees.
- 1 A special type of employee who represents the employer in contractual relations with other persons is an _____.
- 2 In an agency relationship the one who grants authority is the _____.
- 3 In an agency relationship, the one with whom the business is transacted is known as the _____.
- 4 The kind of agent who transacts all his employer's business at a particular place is called a _____ agent.
- 5 An agent who is authorized to perform some specific act or acts is known as a _____ agent.
- 6 When definite and specific powers are granted, the agency is said to be created by _____.
- 7 When an unauthorized act is approved or acknowledged by the employer, agency is said to be created by _____.
- 8 When an employer, by words or conduct, lends a third party to believe that a person has authority to act as an agent, the agency is said to be created by _____.
- 9 When an employee who otherwise does not have authority as an agent finds it necessary to obligate his employer in an emergency, the agency that exists is said to be created by _____.
- 10 The formal written instrument used for the creation of agency by appointment is called a _____.

True-False Questions

Directions After each statement below that is true, draw a line under 'true'. After each statement that is false draw a line under 'false'. The first statement is given as a sample.

- | | | |
|-----|---|-------------------|
| 0 | In determining responsibility of an employer a reasonably safe place to work depends upon the type of work | <u>true</u> false |
| 11. | In general, all those business functions one has a legal right to perform may be performed by an agent | true false |
| 12 | It is the employee's responsibility to instruct himself in the safe use of equipment | true false |
| 13 | An employee may have a claim against his employer for injury as a result of acts of incompetent fellow employees | true false |
| 14. | The employee who is driver of a truck is solely responsible for damages involved in an accident | true false |
| 15 | A clerk is usually an agent in selling merchandise | true false |
| 16 | A man with a title of purchasing agent in a business is an agent by necessity | true false |
| 17 | When an unauthorized clerk buys merchandise that is paid for by the employer agency is created by appointment | true false |
| 18 | If an employee becomes angry and injures a customer the employer is liable for damages | true false |
| 19 | If a clerk wraps merchandise improperly and it is damaged, the employer is responsible | true false |
| 20 | An employer who is on vacation when an employee contracts for repairs on important equipment is bound by the contract of his employee | true false |

Multiple-Choice Questions

Directions Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement.

- | | | |
|-----|---|-----|
| 21. | An employer is responsible to third parties for his agent's (a) negligent acts in line of duty (b) all negligent acts (c) negligent acts outside line of duty | () |
| 22 | An employer may escape liability for injury to an employee if (a) it has been unintentional (b) there has been contributory negligence on the part of the employee (c) a fellow employee has contributed to the cause | () |

- 23 The employer or the employee may terminate employment by giving reasonable notice if (a) employment is based upon a contract, (b) employment is for an indefinite period (c) the contract covers more than five years ()
- 24 An act which creates a justifiable discharge is (a) nonpayment of wages, (b) injurious conditions of employment, (c) willful disobedience ()
- 25 A justifiable reason for abandoning (quitting) a job is (a) assault by employer (b) revealing trade secrets (c) neglect of duty ()

PRACTICAL PROBLEMS

(Chapter XII)

Complete the following problems. If you are doubtful about decisions reread the chapter. After you have completed the exercises you will find suggested solutions on page 303 of this book. You cannot expect that your answers will be exactly the same as those which are suggested but if your answers do not follow in general the suggested solutions reread your text, then write your answers again.

- 12A. The Atlantic Seed Company agreed to buy from Mr J. L. Kramer certain alfalfa seed. The agreement stipulated that the seed was to be cleaned before delivery and payment of the price. The seed was not delivered and the company brought an action for possession. Was this remedy the proper one?
- 12B. Assume that you are an employer. Write a contract of employment between yourself and some employee whom you are hiring. The contract should conform to the essentials of a contract outlined in this chapter and should contain the proper information.
- 12C. Woodruff entered a clothing store for the purpose of buying a suit of clothes. At the suggestion of the salesman Woodruff placed his watch in a drawer from which a vest had been taken for him to try on. After the suit was accepted and paid for Woodruff discovered that his watch had disappeared. Was there an express or an implied agreement on the part of the salesman to become the bailee of the watch?
- 12D. Gilman received a fur coat from Hardy for the purpose of making certain alterations and repairs on it. Gilman furnished labor and materials amounting to \$75. Hardy disputed the amount charged and demanded the return of the

coat. Gilman refused to deliver the coat, claiming that he had a lien against it for the charges. Did Gilman have a lien on the coat?

12E. Beard, without authority, assumed to act as the agent of Grant in the sale of certain goods to Coe. Upon being informed of the sale, Grant approved the unauthorized act of Beard. Later Grant changed his mind and refused to carry out the contract. Grant's defense to a suit brought by Coe was that Beard was not his agent. Was this a good defense?

12F. Waite was employed by the Education Electric Company to install electrical equipment. It was agreed that Waite might either use his automobile or take a train to reach outlying points to which he might be sent, but in either case the company would pay Waite as transportation expense the amount of the railroad fare only. While driving his automobile on such a trip on behalf of the company, Waite negligently injured Finney. Finney sued the Education Electric Company for damages for the injuries suffered. Was the Education Electric Company liable?

CORRESPONDENCE AND DISCUSSION PROBLEMS

(Chapters X, XI, and XII)

If you are a regularly enrolled student in the United States Armed Forces Institute, you are entitled to the assistance from an instructor by correspondence if you wish such assistance. These problems are for that purpose. However, you are not obligated to send in these assignments. If you want suggestions on your work, write out your answers to these assignments and send them to the United States Armed Forces Institute as instructed on page v of this book.

If you are working in a class under an instructor, the assignments may be used for discussion or for written outside work.

1. What may be the advantages of dealing with a large bank?
2. What may be the advantages of dealing with a small bank?
3. On what three main bases do banks lend money?
4. How is the interest on a short-term loan usually handled by a bank?
5. What is the essence of the Robinson-Patman Act, and why is this Act important?
6. What exceptions are made in certain industries with regard to exceeding the maximum number of hours per week?
7. What are the two main types of social security benefits that are provided under the Social Security Act?

8. Are the members of a partnership considered to be employees under the Social Security Act?
9. What are the essentials of a contract?
10. Name some types of contracts that, under various state laws, are required to be in writing.
11. What do you recommend as a wise practice when a contract that has been drawn is to be signed with the understanding that a supplementary agreement will be made later?
12. Short left a suit of clothes with a tailor to be repaired and pressed. Some time during the night a burglar entered the tailor shop and stole the suit.
 - (a) In an action brought against the tailor, was Short entitled to recover the value of the suit?
 - (b) What kind of bailment was this?
 - (c) What degree of care did the tailor owe in this bailment? Why?
 - (d) If the suit had been stolen by an employee of the tailor, would his liability have been different?
13. A man entered a restaurant. He hung his hat and overcoat on a hook on the wall, a few feet distant from the table at which he sat. While he was eating, the coat disappeared.
 - (a) In your judgment was the proprietor of the restaurant liable?
 - (b) Was there a bailment in the case? If so, what kind of bailment was it?
 - (c) If the coat had been left with the cashier, what would have been the liability of the proprietor?
14. The Union Dispatch Company is engaged in the hauling of goods.
 - (a) What determines whether it is a common carrier or a private carrier?
 - (h) Is there any difference between the liability of a common carrier and that of a private carrier?
15. Short had an agreement with the Merchants' Dispatch Company, a common carrier, to carry goods for him on credit. Jones, a business competitor of Short, demanded that the company carry similar goods for him on credit. The company refused to do so.
 - (a) Was the Merchants' Dispatch Company guilty of a violation of the law by making this discrimination?
 - (b) Did the carrier have the right to require one shipper to pay in advance and to allow credit to another? Why?
 - (c) What would be your answer if the goods offered by the two shippers had been of different kinds?
10. Which of the following persons are agents and which are merely employees?

- (a) A cashier in a newspaper office.
 - (b) A person employed to purchase supplies for use in a factory.
 - (c) A conductor on a railway train
 - (d) A person who solicits advertisements for a newspaper.
 - (e) A bookkeeper.
 - (f) The superintendent of a factory
17. If the employee in each of the following situations was discharged before the end of the term of employment for the reason given, did he have a right of action against the employer for damages?
- (a) A cartoonist disregarded orders as to the time of reporting for work
 - (b) A stenographer refused to consent to a reduction in salary
 - (c) An employee refused to buy shares of stock in the corporation for which he worked
 - (d) An employee disclosed a trade secret that he had learned during his employment

END-OF-COURSE REVIEW

This test provides in brief form an opportunity for you to test and recheck yourself on the latter half of this course before taking the End-of Course Test. This review is not an attempt to test you exhaustively on all the topics that you have studied, but it provides a representative sampling of questions on some of the more important topics that you should remember. Answers will be found on page 309 of this book. The questions have been grouped so that you can restudy the chapters that contain answers you missed. At this time you should make a quick check-up of the Mid Course Review and any of the Self-Checking Study Questions about which you are uncertain. This will help you in the preparation for the End-of Course Test. When you have satisfied yourself as to your understanding, you may then take the End-of-Course Test as explained on page v of this book.

Multiple-Choice Questions

Directions: Place in the parentheses at the right of each of the following statements the letter that represents the word or group of words correctly completing the statement. The first is given as a sample.

0. A type of bond which is forfeited if a person or company fails to fulfill a contract is called a (a) performance bond, (b) surety bond, (c) registered bond . . . (a)

(Chapter VIII)

- 1 The kind of insurance which protects the owner of an automobile from loss if the automobile smashes a store window is (a) collision (b) fire (c) property damage ()
- 2 The amount which a businessman pays to an insurance company in buying fire insurance is called (a) assessment, (b) premium, (c) interest ()
- 3 A coinsurance clause is advantageous because (a) more insurance can be carried at a lower rate (b) settlement is easier (c) there is greater state supervision ()
- 4 A so called five and ten clause in an automobile insurance policy refers to (a) \$5 a thousand and \$10 a thousand (b) the maximum assessment, (c) the amount of protection for one injury and for more than one injury in the same accident ()
- 5 A type of risk for which insurance can be commonly obtained is (a) injury to customers (b) price fluctuations (c) strikes ()

(Chapter VIII)

- 6 The kind of records that are most commonly used in business because they provide the best proof of correctness are (a) single-entry records (b) double-entry records (c) the day book ()
- 7 The financial record which shows the amount of assets owned by a business is (a) the balance sheet (b) the profit and loss statement, (c) the income and expense statement ()
- 8 Each customer's charge account should be brought up to date (a) monthly (b) weekly (c) daily ()
- 9 The kind of retail store which should have the greatest gross margin of profit is (a) a hardware store (b) a grocery store (c) a meat store ()
- 10 Operating expenses of a business include (a) purchases (b) depreciation (c) cost of goods sold ()

(Chapter IX)

- 11 Budgeting means essentially (a) planning (b) speculating (c) investing ()
- 12 In preparing a budget the first step is usually (a) counting the cash (b) estimating sales (c) estimating purchases ()

13. Sales will be most likely estimated on the basis of
(a) accounts receivable, (b) margin of profit, (c) past sales ()
14. A cash budget is prepared on the basis of (a) sales,
(h) expenses, (c) receipts and disbursements ()
15. The estimate of purchases is usually based on (a)
sales, (b) cash, (c) advertising ()

(Chapter X)

16. The one who executes a promissory note (agrees to
pay) is the (a) indorser, (h) maker, (c) payee ()
17. The one to whom a negotiable instrument has been
transferred by indorsement is (a) the indorsee (b)
the drawee, (c) the payee ()
18. A check which is used by one bank to draw on funds
it has deposited in another bank is (a) a bank draft,
(b) a cashier's check, (c) a certified check ()
19. A check drawn by a businessman, the payment of
which is guaranteed by a bank, is (a) a cashier's
check, (b) a money order, (c) a certified check ()
20. Common practice in borrowing on a short term loan
from a bank is to (a) receive the amount of the loan
less the interest, (b) pay the interest when the loan
is repaid, (c) get the full amount of the loan but pay
the interest in advance ()

(Chapter XI)

21. The governmental agency which administers the fair
trade laws is (a) the United States Department of
Commerce, (b) the Federal Trade Commission, (c)
the Interstate Commerce Commission ()
22. Labeling of drugs sold in interstate commerce is con-
trolled by (a) the Federal Food, Drug, and Cosmetic
Act, (b) the Federal Trade Commission, (c) the In-
terstate Commerce Commission ()
23. The Robinson Patman Act is designed to (a) estab-
lish price fixing, (b) prevent discrimination in busi-
ness dealings, (c) prevent excess profits ()
24. Under the Federal Income Tax Withholding plan (a)
the employer pays the tax, (b) the employer withholds
the tax from the wages of employees and pays it to
the government, (c) both the employer and the em-
ployee pay the tax ()
25. The employers' tax for Federal Old Age Benefits is
(a) 3 per cent on the first thousand dollars yearly
wage paid to an employee, (b) 2 per cent on the first

three thousand dollars yearly wage paid to an employee (c) 1 per cent on the first three thousand dollars yearly wage paid to an employee ()

(Chapter XII)

- 26 When goods are sold f o b the shipping point, the title passes to the buyer (a) at time of shipment, (b) at time of delivery (c) any time the buyer wishes ()
- 27 Acceptance of goods may be indicated by (a) acknowledging the arrival of the goods (b) keeping the goods three months (c) opening the package ()
- 28 A common carrier must (a) accept all goods offered it for shipment (b) accept without discrimination all goods that it usually transports (c) accept goods only from customers in a predetermined area ()
- 29 A private carrier (a) must accept all goods offered it for shipment (b) must accept all goods that are customarily hauled, (c) may haul only the goods it chooses ()
- 30 An employer is responsible to third parties for an act of an employee as follows (a) negligent act in line of duty (b) all negligent acts (c) negligent act outside line of duty ()

True False Questions

(Chapter VIII)

31. Policyholders in a mutual fire insurance company may be required to pay an assessment true false
- 32 Railway express shipments are insured without extra charge up to but not to exceed \$500 in value true false
- 33 It is desirable to carry straight fire insurance on a value greater than the total value of the building to assure complete coverage true false
- 34 Marine insurance is the same as transportation insurance true false
- 35 Use and occupancy insurance will reimburse a business for loss of any essential piece of equipment true false

(Chapter VIII)

- 36 A ratio of current assets to current liabilities of 1 to 2 is a good ratio true false
- 37 A charge for depreciation may be included as an expense in the Federal income tax return for a business true false

- 38 A balance sheet for a business is usually prepared weekly true false
- 39 The cost of merchandise is considered a part of operating expenses of a business true false
- 40 A successful grocery store should expect a net profit or net operating profit of at least 10 per cent true false

(Chapter IX)

- 41 After a budget is established it should be followed without change true false
- 42 The sales and advertising budgets influence each other true false
- 43 A budget is more of a planning guide than a bookkeeping process true false
- 44 A sales estimate is sometimes based upon products departments and salesmen true false
- 45 The purchase budget is usually the first part of the budget prepared true false

(Chapter X)

- 46 A cashier's check may be transferred by indorsement true false
- 47 There is a mistake in the bank statement or the checkbook balance unless the balance shown on the bank statement coincides with the balance on the checkbook stub true false
- 48 By special agreement a bank may charge more than the legal rate of interest true false
- 49 If a businessman borrows \$1000 for 90 days at 6 per cent interest the amount that he will receive from the bank is \$1000 true false
- 50 The maximum insurance for each depositor in a bank which is a member of the Federal Depositors Insurance Corporation is \$10 000 true false

(Chapter XI)

- 51 The Interstate Commerce Commission determines the rate charged by a railroad on such an item as potatoes true false
- 52 Manufacturers who are members of an association may all agree to sell their products at the same price true false
- 53 The Tydings Miller Act helps to protect the small businessman true false

- 54 If you want information about the quality of a product, you may get this information from the National Bureau of Standards true false
- 55 The Printers Ink Model Statute applies to dishonest advertising true false
- 56 Every employee of a business must have a social security number true false
- 57 The partners of a partnership are considered as employees under the Social Security Act true false
- 58 The employee has the option of paying his social security tax directly to the government rather than having it deducted from his wages true false
- 59 A widow may receive benefits under the Social Security Act true false
- 60 It is common practice in cities to require a license for the operation of a restaurant true false

(Chapter XII)

- 61 The first essential of a contract is agreement true false
- 62 If the buyer of merchandise fails to perform his part of a contract, the seller may sue for payment if the title has passed true false
- 63 If the seller fails to transfer title to goods under a contract the buyer may rescind the contract true false
- 64 The relationship of a bailment is either an express or an implied contract true false
- 65 One who takes lost property into his possession has created an act of bailment true false
- 66 A bailment for the sole benefit of the bailee requires only ordinary care on the part of the bailee true false
- 67 A trucking company which hauls goods for certain selected individuals on a contract basis is a common carrier true false
- 68 The sales clerk in a store is serving as an agent true false
- 69 An employer is responsible to the buyer for the damage that results from improper wrapping or handling of merchandise sold by a clerk true false
- 70 If an authorized agent is driving with his family on Sunday and injures a third party the employer is probably legally responsible for the damages true false

ANSWERS TO SELF-CHECKING STUDY QUESTIONS

General Comment: Answers are given below for the Self-Checking Study Questions at the end of each chapter and of each section. If you miss a question, refer to the page in your textbook where this question is discussed. You should review the discussion pertaining to the answer that you have missed before proceeding with the next assignment.

Chapter I

Answers	For review see page
1. True	2
2. False	2
3. True	9
4. False	1
5. False	9
6. True	10
7. False	9
8. True	14
9. True	5 10
10. False	7 8
11. True	10
12. False	10
13. True	3
14. False	11
15. False	10
16. b	8
17. c	8
18. a	2
19. c	12
20. b	4
21. c	7
22. c	6 7 8
23. a	12
24. b	10
25. c	12
26. b	2
27. a	10
28. c	2
29. a	10
30. b	3

Chapter II

1. True	15
2. True	26
3. False	19 20
4. False	25
5. True	25
6. False	19 24
7. True	19
8. False	24
9. True	19
10. True	20
11. True	24, 25
12. False	24
13. False	19
14. True	26
15. False	26

Chapter II

Answers	For review see page
16. a	26
17. c	26
18. b	26
19. b	18
20. c	19
21. a	19 24
22. b	19
23. c	21
24. b	21
25. a	21
26. a	26
27. c	26
28. b	26
29. b	26
30. b	29

Chapter III, Section I

Answers	For review see page
1. False	31
2. False	31, 33
3. False	33
4. True	32
5. True	32
6. True	30
7. False	33 40
8. False	33
9. True	39
10. True	39
11. b	30
12. a	31
13. a	33
14. b	34
15. a	33, 36
16. c	38
17. b	33
18. a	39 40
19. b	41
20. c	41

Chapter III, Section II

Answers	For review see page
1. a. stock holders	46 49
2. Stock	51
3. Cumu- lative	54
4. Bond	57 59
5. Open	51
6. True	62
7. False	46
8. True	46
9. False	46
10. True	62
11. c	46
12. c	49
13. b	51
14. b	51
15. a	52
16. b	52
17. c	52
18. a	55
19. c	59
20. a	64

Chapter IV

Answers	For review see page
1. True	70
2. False	70
3. False	70
4. True	70
5. False	70
6. True	71, 72
7. True	70, 75
8. True	71
9. False	75
10. False	76
11. b	70
12. a	76
13. c	75
14. b	75
15. c	70 76

Chapter V

Answers	For review see page
1 Lease	82
2 Lessor	82
3 Lessee	82
4 Landlord	82
5 Tenant	82
6 False	81
7 True	81
8 False	82
9 True	86
10 True	89
11 False	92
12 False	92
13 True	90
14 False	81
15 True	86
16 c	89
17 a	62
18 b	66
19 a	64 92
20 a	84

Chapter VI

Answers	For review see page
1 True	98
2 False	104
3 True	101
4 True	105
5 False	109
6 True	111
7 False	113
8 True	112
9 True	117
10 False	120
11 a	98
12 c	114
13 b	102
14 a	113
15 b	114

Chapter VII

Answers	For review see page
1 Stock holders	133
2 Trans- portation	147
3 Surety	152
4 Perform- ance	152
5 Hedging	131

Chapter VII

Answers	For review see page
6 True	153
7 False	134
8 True	130
9 False	134
10 False	135
11 False	136 144
12 True	140
13 True	131
14 False	150
15 True	152
16 b	141
17 c	141
18 b	138
19 b	149
20 a	147

Chapter VIII

Answers	For review see page
1 True	158
2 False	153
3 True	158
4 False	163
5 True	164
6 True	167
7 True	160
8 False	161 170
9 False	171
10 True	176 176
11 b	160
12 b	160
13 c	159
14 a	160
15 b	161
16 a	171
17 c	170
18 a	166
19 c	174
20 a	163

Chapter IX

Answers	For review see page
1 False	184
2 False	169
3 True	187
4 False	192
5 True	167
6 False	190 192
7 True	183 164
9 False	189 192
9 True	189
10 True	166

Chapter IX

Answers	For review see page
11 b	183
12 c	189
13 a	189
14 b	190 191
15 a	189

Chapter X

Answers	For review see page
1 False	196
2 False	197
3 True	198
4 True	198
5 False	200 201
6 True	201
7 True	202
8 True	202
9 True	203
10 False	204
11 True	206
12 False	207
13 False	209
14 True	210
15 True	210
16 True	211
17 False	212 213
18 False	213
19 True	213
20 True	213
21 c	207
22 f	211
23 d	211
24 f	211
25 a	209

Chapter XI

Section I

Answers	For review see page
1 True	220
2 False	227
3 False	232
4 False	225
5 True	224
6 True	225
7 False	225
8 False	226
9 False	228
10 True	226
11 False	223
12 True	230
13 True	234
14 False	240
15 True	241

Chapter XI, Section I

Answers	For review see page
16 b	220
17 c	222
18 b	226
19 b	228
20 a	231
21 a	235
22 a	236
23 b	237
24 c	237
25 b	239

Chapter XI, Section II

Answers	For review see page
1 False	244
2 True	244
3 False	244
4 True	244, 245
5 True	245
6 True	245
7 True	246
8 False	247
9 True	248
10 True	248
11 c	244
12 c	244
13 b	245
14 b	245
15 b	249

Chapter XII, Section I

Answers	For review see page
1 Contract	255
2 Voidable	268
3 Puffs	263
4 Warranty	263
5 Reasonable	266
6 False	267
7 False	268
8 True	267
9 True	267
10 False	266
11 True	267, 268
12 True	267
13 False	265
14 True	264
15 True	263
16 a	267
17 a	267
18 c	266
19 a	267
20 b	264

Chapter XII, Section II

Answers	For review see page
1 Security	273
2 Bailor	271
3 Bailee	271
4 Bailee	272
5 Contract	271
6 Pawnor	274
7 Pawnee	274
8 Common	275
9 Private	275
10 Act of God	277
11 True	273
12 False	275
13 False	275
14 True	274
15 False	278
16 a	276
17 a	277
18 b	278
19 c	277
20 a	274

Chapter XII, Section III

Answers	For review see page
1 Agent	285
2 Principal	285
3 Third party	285, 288
4 General	288
5 Special	286
6 Appointment	286
7 Ratification	286
8 Estoppel	287
9 Necessity	287
10 Power of Attorney	286
11 True	285
12 False	282
13 True	283
14 False	283
15 True	286
16 False	287
17 False	286
18 True	283
19 True	283
20 True	287
21 a	283
22 b	283
23 b	283
24 c	283
25 a	284

ANSWERS TO PRACTICAL PROBLEMS

General Comment The following are answers to the Practical Problems at the end of each chapter. The answers for most of the problems are given exactly. If you do not get the right answers re-study your textbook and write the solutions again. For those problems for which exact answers cannot be given your solutions should follow in general those given in these answers. If your answers do not follow the solutions in general you should re-study your textbook and prepare new solutions.

Chapter I

- 1A. Obtain a plant
 Arrange for financing
 Obtain sources of milk
 Obtain equipment and supplies
 Hire help
 Obtain publicity and make contacts with new customers
 Arrange for insurance
 Manage the business
- 1B. Competition
 Capital
 Location
 Changes in products
 Changes in methods
 Personal health
 Taxes
 Business conditions
 Credit losses
 Excessive expenses
- 1C. Check your qualifications in terms of the points given in the textbook under the headings "Selecting the Type of Business" and "Qualifications for Success." Add any additional factors about yourself that you consider important in this particular type of business

Chapter II

- 2A.
- | | |
|--|--|
| \$1874 00 Monthly expenses | |
| 200 00 Salary per month | |
| 10 00 Profit per month | |
| \$2034 00 Total monthly income that must be earned | |

2B.	
Sales	\$2 000 00
Cost of Goods Sold	1,200 00
Gross Profit	800 00
Operating Expenses	
Rent	\$34 00
Heat, light, and power	12 00
Taxes and licenses	16 00
Insurance	16 00
Interest	16 00
Boxes, wrapping and other packing material	4 00
Postage including parcel post	6 00
Depreciation other than that on delivery equipment repairs	4 00
Advertising	33 00
Total Expenses	194 00
Net Profit	\$ 606 00
2C. (a) Total cash required to operate the business for one month assuming no income	is \$2 153.50
(b) Total amount required in Part (a)	\$2 153.50
Additional amount needed for purchases	160 00
Total	\$2,313.50
Amt. from sales \$700 00	
Amt. from bank 497.50	
Amount of additional cash available	697.50
Min. amount of cash needed	\$1 621.00

Chapter III

3A. (a) Each partner will get $\frac{1}{3}$ of \$4 000 or \$1 333 33 (b) The new financial statement will be as follows

ASSETS

Cash	\$ 1 800
Merchandise	11 500
Equipment	10 000
Land and Building	16 500
Total Assets	<u>\$39,800</u>

CLAIMS AGAINST ASSETS

Accounts Payable (debts)	\$ 800
B S Davis, Proprietorship	13,000
W H Baker, Proprietorship	13 000
J W Miller, Proprietorship	<u>13 000</u>
Total Claims Against Assets	<u>\$39,800</u>

3B Mr Taylor, \$2,100, Mr Williams \$1,400

3C $\$3\ 600 \div 12 = \300 per month, which is \$100 per month for each partner. The estate of Mr Miller would receive \$300 for the three months of the fiscal year. The \$3 300 should be divided equally between Mr Davis and Mr Baker.

3D (a) \$100 000 authorized capital stock @ \$50 per \$1,000 = \$50 organization tax

(b) 800 shares of common and 400 shares of preferred

(c) \$68 000 (net worth) \div 1 200 shares outstanding = \$56 67

(d) The preferred would receive \$1 400 (7% of \$20,000) and the common would get \$2 000, which would be a 5% dividend (\$2 000 \div \$40 000). Mr Goodman would receive \$25 on his common stock and \$87 50 on his preferred stock.

(e) The cumulative preferred stockholders would receive 14% of \$20 000, or \$2 800. The common would receive \$3,200.

Chapter IV

4A In considering a suitable location, you should include such factors as population, purchasing power, number of businesses already serving the community, types of business characteristics of the existing businesses, needs of the community, possible expansion of the community, traffic, transportation and rental cost.

4B Take into consideration some of the factors in the previous problem, but also take into consideration the types of businesses, the amount of competition, the nature of the community, the type of store and the known buying habits of the community.

4C Take into consideration all the factors indicated in the first two problems, giving both advantages and disadvantages of the location.

Chapter V

5A

(a) $\$143\ 50 \div 287 = \500
 (b) $\$35 - 064 = \$546\ 88$

5B

Taxes	\$ 382 50
Insurance	40 00
Repairs	200 00
Depreciation	400 00
Interest	1 000 00

\$2 022 50 Total annual cost to buy

\$2,400 00 Annual cost to lease

2 022 50 Annual cost to buy

\$ 377 50 Better to buy (but repairs and depreciation are only estimates)

5C \$2 250

Chapter VI

6A (a) $50 \times 304 \times 1 = 15\ 200$ oz $\div 16 = 950$ lbs

(b) Wholesale value (950 \times \$24 = \$228) Retail value (950 \times \$32 = \$304)

6B $\$385 - \$80 = \$305$ 4% of \$305 = \$12 20 finance charge
 $\$305 + \$12\ 20 = \$317\ 20 \div 12 = \$26\ 43\frac{1}{3}$ monthly payment.

Eight of the monthly payments will be \$26.43 and four of them will be \$26.44

Chapter VII

6C.
Cement press (\$35 + \$12) \$ 47.00

Stitching machine
Initial fee \$200.00
January (minimum charge) 5.00
February 7.20
March 7.80
April 7.20
May 8.40
June 7.56
July 6.60
August 6.00
September 6.00
October 8.40
November 7.44
December 6.36 236.96

Total Rental for year \$333.96

7A.

\$19 000

\$19 800

7B.

$$\times \$6 000 = \$5 757.58$$

AMOUNT PAID BY INSURANCE COMPANY	LOSS BORNE BY INSURED
\$3 000 00	\$1 000 00
7 111 11	838 89
4 444 44	555 56
4 000 00	2 000 00
6 000 00	3 000 00
9 000 00	0

7C. $\$200 000 \div 52 = \$3 846 15$
weekly amount.

7D. The figures must be based upon some particular calendar year and should indicate the actual weeks according to the days on the calendar. If the year 1939 is used, the table will be as follows although for some other year the figures would be different.

	PER WEEK		NO OF WEEKS	INSURANCE
April 30 to July 1	\$3 888 89	X	9	\$ 80 000
July 2 to April 29	2 790 70	X	43	120 000
Total			<u>52</u>	<u>\$200 000</u>

8A.

Chapter VIII

Total Sales	\$28 150 34	100.00%
Cost of Goods Sold	<u>21 654 80</u>	76.93
Gross Profit on Sales		\$6 495.54 23.07
Operating Expenses		
Salaries and Wages	3 000 00	10.66
Advertising	156 10	00.55
Donations	123 05	00.44
Supplies Used	80 45	00.32
Office Expense	33 15	00.12
Telephone and Telegraph	41 00	00.15
Delivery Expense	410 00	01.46
Taxes and Insurance	150 05	00.53
Rent	624 00	02.22
Heat, Light, and Water	123 15	00.44
Loss from Bad Debts	205 44	00.73
Interest Paid	52 00	00.18
Repairs and Depreciation	259 00	01.03
Other Expense	<u>123 04</u>	00.44
Total Operating Expenses		5 420 43 19.26
Net Profit		<u>\$1 075 11</u> 3.82

8B (a) Two years' depreciation on the automobile will be \$300 The net value of the automobile will therefore be \$500

(b) Seven years' depreciation on the building will be \$1,400

The net value of the building will therefore be \$8 600

(c) Seven years depreciation on the equipment will be \$420 The net value of the equipment will therefore be \$1,580

8C

**Schedule D—PROFIT (OR LOSS) FROM BUSINESS
OR PROFESSION**

1	Total receipts (state nature of business or profession)	\$9 109 41
COST OF GOODS SOLD		
2	Labor	\$2,229 56
3	Material and supplies	167 00
4	Merchandise bought for sale	1 654 02
5	Other costs	294 43
6	Plus inventory at beginning of year	1 250 00
7	Total (lines 2 to 6)	<u>\$5,595 01</u>
8	Less inventory at end of year	955 07
9	Net cost of goods sold (line 7 minus line 8)	<u>\$4 639 94</u>

Enter "C," or "C'" or "M" on lines 6 and 8 to indicate whether inventories are valued at cost or cost or market, whichever is lower

OTHER BUSINESS DEDUCTIONS

10	Salaries not included as "Labor"	\$ 502 99
11	Interest on business indebtedness	94 00
12	Taxes on business and business property	861 24
13	Losses	90 00
14	Bad debts arising from sales or services	298 47
15	Depreciation, obsolescence, and depletion	51 00
16	Rent, repairs, and other expenses	1 809 11
17	Total (lines 10 to 16)	<u>\$3 706 81</u>
18	Total deductions (line 9 plus line 17)	8,346 75
19	Net profit (or loss) (line 1 minus line 18)	<u>\$ 762 66</u>

823

DAILY SUMMARY STATEMENT PREPARED FROM CLEVER DAILY BALANCE SLIPS										
Date	Sales to Retail	Paid Out to Wholesale	Total Paid Outgoing	Received on Account	Cash Paid Out	Cash		Money Paid Outgoing	Cash Paid Out	Total Paid Outgoing
						On Hand	Out			
A	\$ 13.21		\$ 13.21	\$ 3.25	\$11.06				\$ 7.82	\$ 19.20
B	21.64	\$1.12	23.79	36.00	13.34	\$ 13			6.21	21.20
D	19.73	\$.46	21.23	33.36	7.83			\$7.00	12.73	21.40
E	66.06		\$6.06	3.25	14.06	.25			\$ 23	36.30
G	66.26	\$.05	20.34	\$.06	\$4.14				7.44	43.00
TOTAL	\$112.97	\$4.20	\$120.27	\$36.20	\$24.07	\$.40		\$13.00	\$42.06	\$120.43

Chapter IX

9A.

H J BROOKS

Budget for Six Months Ending June 30, 194-

INCOME EXPENSE, PROFIT	AMOUNTS BUDGETED FOR NEXT SIX MONTHS	ESTIMATED PERCENTAGES OF SALES
Total Income from Sales	\$21 000 00	100 00%
Cost of Merchandise Sold	16 128 00	76 80
Gross Profit on Sales	4 872 00	23 20
Salaries and Wages	\$ 2,630 00	12 52
Advertising	332 15	1 58
Donations	25 00	.12
Supplies Used	63 00	.30
Miscellaneous Office Expense	34 75	.17
Telephone and Telegraph Service	47 50	.23
Delivery Expense	305 15	1 45
Taxes and Insurance	160 05	.76
Rent	600 00	2 86
Heat, Light, and Water	147 12	.70
Loss from Bad Debts	231 00	1 10
Interest Paid	60 00	.29
Repairs and Depreciation	150 00	.71
Other Expense	122 23	.58
Total Operating Expenses	\$ 4 907 65	23 37%
Net Loss	\$ 35 65	17%

9B

CASH FORECAST

3 months beginning July 1

	JULY	AUGUST	SEPTEMBER
Cash on hand at beginning of month	\$ 2 207	\$ 2,329 00	\$ 2 438.80
Receipts			
Collections from accounts receivable	15 227	13 704 30	13 704.30
Other receipts	2 958	2 662 20	2 662 20
Total receipts	\$18 185	\$16 366 50	\$16 366 50
Total Cash Available	\$20 392	\$18 695 50	\$18 805 30
Disbursements			
Pay roll	\$10 823	\$ 9 740 70	\$ 9 740 70
Production materials	6 411	5 769 90	5 769 90
Supplies and expenses	329	296 10	296 10
Construction and plant additions			
Other disbursements (repayment of loan, etc.)	500	450 00	450 00
Total disbursements	\$18 063	\$16 256 70	\$16 256 70
Estimated cash at end of month	\$ 2 329	\$ 2 438 80	\$ 2 548 60

9C		May	\$ 3 150 fans 1 750 lamps 11 375 refrigerators <u>\$16,275</u>
January	\$ 5 950, ranges 1,750, heaters 1,750, lamps <u>\$ 9,450</u>	July	\$ 1 575 fans 11,375 refrigerators <u>\$12 950</u>
June	\$ 1,575, fans	September	\$ 5 950 ranges 1 750 lamps <u>\$ 7 700</u>
August	\$ 5 950, ranges	November	\$ 1 750 heaters
October	\$ 1,750, heaters		\$89 600 in cash must be available for the total purchases of the year
December	\$ 5 950, ranges 1,750, heaters 1,750, lamps 22,750, refrigerators <u>\$32,200</u>		

Chapter X

10A.

$\frac{5}{10}$ of \$1.50, service credit on \$1,000 =	\$1.20, service credit
30 checks written @ 3 cents each = \$.90	
70 checks deposited @ $1\frac{1}{2}$ cents each = 1 05	
Total service charge	<u>1 95</u>
Excess of service charge over service credit =	\$ 75

10B.

$$\begin{aligned}
 \$500 \times \frac{20}{360} \times \frac{6}{100} &= \$1.67, \\
 &\text{Interest.} \\
 \$576.50 \times 2\% &= \$11.53, \text{ discount.} \\
 \$11.53 - \$1.67 &= \$9.86, \text{ amount} \\
 &\text{saved.}
 \end{aligned}$$

10C.

$$\begin{aligned}
 \$100 \times \frac{30}{360} \times \frac{6}{100} &= \$50, \text{ credit} \\
 &\text{allowed for} \\
 &\text{30 days' interest.} \\
 \$100 - \$50 &= \$99.50, \text{ amount to} \\
 &\text{be paid} \\
 &\text{back.}
 \end{aligned}$$

10D (a)

Balance on the bank statement	\$993.09
Total of checks still outstanding	62.90
Checkbook balance	\$930.19

(b) Compare the figures on the check stubs with the figures on the bank statement again. Verify computations on the bank statement. Recheck all additions and subtractions in the checkbook. There obviously would be a mistake in addition or subtraction if the check stubs agreed with all the items on the bank statement.

Chapter XI

11A. (a) As a certain percentage of the wages paid (1 per cent until 1945 unless the percentage is changed by law) Wages of individuals are taxed only to the extent of the first \$3 000 earned by each individual
(b) \$517.70 (c) \$465.93

$$11B \quad \$7,560 \times .0214 = \$161.78.$$

$$11C \quad (a) \quad .017 \times \$1,000 = \$17.00$$

$$(b) \quad \$15,422.50 \times .017 = \$262.18.$$

Chapter XII

12A. No. This was merely a contract to sell, and the title had not passed. The buyer should have brought an action to recover damages arising out of the breach of contract.

12B. The contract should measure up to the essentials, such as agreement, consent, and the like, and should contain the proper information, such as the date and the place, the names of the parties, a statement of the purpose, a statement of the money, the services or the goods to be given in consideration, the acts to be performed by each party, and the signatures of the parties.

12C. This was an implied bailment. 'When a merchant opens a place of business and invites the public to come there for the transaction of business there arises an implied contract that no harm or damage shall happen to the property of those who come there.'

12D. Gilman is entitled to retain possession of the coat by reason of his lien. A bailee has a specific lien on the subject matter of the bailment as security. In some states however, Hardy might recover possession of the coat by giving a bond for the amount of the disputed bill, and in a court action attempt to show that the charges were unreasonable.

12E. This was not a good defense. Ratification of an act done by one assuming to be an agent, with full knowledge of all the circumstances, is equivalent to a prior authority.

12F. The Education Electric Company was held not to be liable because it had no right to control the employee in the operation of his automobile.

ANSWERS TO REVIEW QUESTIONS

General Comment Since these reviews are only a general sampling of the subject matter you should review carefully the entire chapter in which you make two or more errors.

Answers to Mid-Course Review Questions

CHAPTER I	CHAPTER IV	CHAPTER I	CHAPTER IV
1 c	16 c	31 false	46 true
2 c	17 b	32 true	47 true
3 b	18 a	33 true	48 false
4 b	19 c	34 true	49 false
5 a	20 b	25 true	50 false
CHAPTER II	CHAPTER V	CHAPTER II	CHAPTER V
6 b	21 b	36 false	51 true
7 c	22 c	37 false	52 true
8 a	23 c	38 false	53 true
9 c	24 c	39 true	54 true
10 b	25 b	40 false	55 true
CHAPTER III	CHAPTER VI	CHAPTER III	CHAPTER VI
11 a	26 c	41 false	56 true
12 b	27 c	42 true	57 true
13 a	28 b	43 true	58 false
14 c	29 a	44 false	59 true
15 a	30 b	45 true	60 false

Answers to End-of-Course Review Questions

CHAPTER VII	CHAPTER X	CHAPTER VII	CHAPTER XII
1. c	16 b	31 true	51 true
2. b	17 a	32 false	52. false
3 a	18 a	33 false	53 true
4 c	19 c	34 true	54 false
5 a	20 a	25 false	55 true
			56 true
CHAPTER VIII	CHAPTER XI	CHAPTER VIII	57 false
6 b	21 b	36 false	58 false
7 a	22 a	37 true	59 true
8 c	23 b	38 false	60 true
9 a	24 b	39 false	
10 b	25 c	40 false	CHAPTER XIII
			61. true
CHAPTER IX	CHAPTER XII	CHAPTER IX	62 true
11 a	26 a	41 false	63 true
12 b	27 b	42 true	64. true
13 c	28 b	43 true	65 true
14 c	29 c	44 true	66 false
15 a	30 a	45 false	67 false
			68 true
		CHAPTER X	69 true
		46 true	70 false
		47 false	
		48 true	
		49 false	
		50 false	

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